CHAPTER 5 Small Business Entry: Paths to Part-Time Entrepreneurship Page 119 LEARNING OBJECTIVES After you complete this chapter, you will be able to: LO 5-1 Describe when and why part-time businesses are important. LO 5-2 Describe the conditions that make part-time entrepreneurship a good decision. LO 5-3 Describe the kinds of part-time entrepreneurship that exist. LO 5-4 Describe the key factors to making a decision to go into part-time entrepreneurship. LO 5-5 Use the BRIE model to describe what it takes to be successful in part-time entrepreneurship. LO 5-6 Describe the advantages and pitfalls of delegating and outsourcing. LO 5-7Identify the ethical challenges of part-time entrepreneurship. LO 5-8 Describe the challenges of moving from part-time to full-time entrepreneurship. • Carla Brauer moved from a hobby into a business of cleaning animal skulls and making wall mounts and jewelry items from the cleaned skulls. What business would you start if you want to work the business part time? Carla Brauer Focus on Small Business: Carla Brauer In a way, it all began with a goat's head. Carla Brauer grew up in the city, but always dreamed of a country life. After college, she found work as a copy editor to be tedious, so she left the city for the boonies and found work on small farms. There, among other skills, she learned to humanely butcher animals grown specifically for that purpose. On a day dedicated to slaughtering some goats, one animal in particular had impressive large, symmetrical horns. Although, by her own admission, she really did not know how to go about it, she determined to de-flesh that goat's head, clean and bleach the bone, and turn it into a wall mount. She had absolutely no idea that she had just taken the first step in entering into a small business of making mounts of the heads of trophy animals. Goat skull with large symmetrical horns Carla Brauer Her approach to this process was to put the head into an unused fenced animal pen so that large scavengers could not carry it away, and then just wait for nature to take its course. This experiment soon had elements of a horror movie. Carla had vultures perching on top of the cage, and the rotting skull was covered in flies and developing maggots. The stench was nearly intolerable. Page 120 But Carla persisted. She experimented with burying a head in an ant colony. Didn't work. No matter how energetic the ants, the results were unsatisfactory. So she tried boiling a head to soften the meat and sinews which she then tediously scraped from the skull. This process was both stinky and very messy. Carla soon realized if she was to continue this hobby, she had to find a better way. One evening in an episode of the TV series Bones the leading character, Temperance Brennan, a forensic anthropologist, proceeded to clean skeletal remains by placing them into a terrarium with a bunch of dermestid beetles. Intrigued, Carla began conducting research into whether or not such an approach would actually work. Soon she discovered that not only were dermestid beetles commonly used for cleaning skeletal remains, but there is an active market for the beetles. Soon she was equipped with a terrarium and a starter batch of beetles. Her first project for her new "employees" was to clean the head of a quail which

had been farm raised and then butchered for its meat. This quail head was followed by the heads of a variety of animals. As her skill grew, so did her reputation. Friends asked her to make wall mounts of the special animals: a young person's first deer, a hunter's largest bull elk, even a bereaved owner's beloved pet. And so the business Dermestidarium was created. After years of cleaning skulls and making mounts first as a hobby and later as a side hustle, Carla now maintains a part-time job in town and runs her skull-cleaning business as her primary enterprise. DISCUSSION QUESTIONS How would you handle the conflicting demands of being a loyal employee while at the same time running your own part time business? What are the ethical concerns when you are working full time for one company and part time for yourself? How would you recommend managing these issues? Carla Brauer currently is busiest during the fall and winter months of the hunting season. How might she obtain work to better utilize the time available during the rest of the year? LEARN MORE ONLINE Learn more about the topics above at these sites: Dermestid beetles at work: www.pbs.org/video/deep-look-hungry-beetles/ Side hustles: www.entrepreneur.com/article/325932 and www.forbes.com/sites/abdoriani/2019/01/28/how-to-finally-turn-your-side-hustle-into-a-full-time-business/#69280250f139

Why Part-Time Businesses Are Important 5-1 Describe when and why part-time businesses are important. Carla Brauer's experience is a common one. She graduated from college and proceeded to work for various businesses in her field. Later, while working a full-time job, she became dissatisfied and began to consider other opportunities. She found employment working on a small farm where she developed skills in horticulture and animal husbandry. This employment led her to become interested in a topic that was completely new to her: preserving animal parts as trophies. The interest became a hobby and the hobby became a part-time business which is now evolving into a successful full-time business. When we talk about businesspeople like Brauer, we often use the terms part-time employment and full-time employment, which are usually understood to mean working 35 or fewer hours a week and working more than 35 hours a week, respectively. However, these terms do not cover the many patterns of employment available to entrepreneurs. In addition to working a specified number of hours each week, entrepreneurs may work on an occasional basis. Consider the people who buy and resell items on eBay, Etsy, or Craig's List websites. These entrepreneurs may not have regular "e-stores" but may sell items as the opportunity provides. And there are many artisans who sell their services or products only when they choose to. These are certainly not considered

full-time businesses, but because they're not working regular hours they don't really fit the definition of either. Page 121 The great variety of ways people choose to conduct business makes it necessary to use additional terms to describe employment patterns. Businesses such as "pop-up" restaurants and pop-up retailers are often called episodic businesses. This is because the same business is run at differing locations and at differing times without having any permanent location or hours of operation. Episodic businesses offer many different services and products. For example, the college student who paints houses in the summer, the gardener who opens a produce stand during harvest, the hustler who sets up a fireworks stand each June, the vendor who follows a summer schedule of state and local fairs, or the skier who offers skiing lessons during the winter are all examples of episodic businesses. Or, how would you describe an entrepreneur who keeps a job as an employee, but not necessarily a full-time job, while starting and running a business at the same time? In this case, the entrepreneur may work more than 35 hours per week in each job. Is this "double-time" employment? No, a different name is needed. Some are calling such employment patterns hybrid entrepreneurship.1 If a person keeps a constant job as an employee and at the same time works at his or her own business, that person is a hybrid entrepreneur. But the number of hours worked at either is not what defines hybrid entrepreneurship. For this book, we will adopt the term part-time business to describe all the previously mentioned employment patterns. What matters in this definition is that the entrepreneur is not working full time at his or her own business but instead is working fewer than 35 hours per week, only a few days per month, or only during certain seasons. The person may or may not be keeping a full- or part-time position as an employee while running a part-time business. When you enter businesses as an entrepreneur, you are not required to work full time. There is no rule that says you must make your living from the business. You get to decide what is right for you. You may "go for broke" and risk all your resources on a full-time business. Or, you may just "hedge your bet" by keeping your day job while you feel your way into the business on a part-time basis. Today, Carla Brauer keeps a part-time job, but also cleans and mounts animal skulls and other skeletal parts. As she is keeping a job for wages and at the same time working fewer than 35 hours a week at Dermestidarium, it is considered to be a part-time business. This chapter focuses on part-time approaches to business. Why does it deserve a whole chapter? There are two reasons. First, most entrepreneurs start out working part time on their new business. According to the Panel Study of Entrepreneurial Dynamics (PSED), three-quarters of new businesses start on a part-time basis.2 This includes the businesses shown in Table 5.1. The ease and low cost of entry and exit make part-time entrepreneurship a great way to try a variety of different businesses without "betting the farm" each time a new business is started. TABLE 5.1 Famous Organizations Started by Part-Time Entrepreneurs3Table Summary: Table divided into two columns summarizes list of companies started by hybrid

entrepreneurs. Accion Friendster American Information Systems Lionel Trains Apple Mary Kay Cosmetics Dell Microsoft Facebook Netscape Ford Modeling Agency Yahoo! Sources: Joseph J. Fucini and Suzy Fucini, Entrepreneurs: The Men and Women behind Famous Brand Names and How They Made It (Boston: G. K. Hall, 1985); Brendan Howard, "Making Time: Not Ready for the Burden of a Full-Time Business? How Do Your Evenings and Weekends Look?," Entrepreneur, June 2000; Adam Cohen, The Perfect Store: Inside eBay (Boston: Back Bay Books, 2003). Page 122 Second, the sheer number of part-time businesses makes them a major force in our economy, even if it is one we do not always recognize. Officially, of the 25.9 million small businesses in the United States in 2012, almost half (10.8 million) were part-time businesses.4 However, that understates the situation. Many people jump into and out of self-employment (a change called volatility by economists) for a few weeks at a time, perhaps because they do project-based work like taking on a single consulting project in their spare time, or doing someone's taxes, or selling an item or two on eBay or at a garage sale. These very short-term projects get missed in the count of new business start-ups. The U.S. Census Bureau reported that during the first three quarters of 2018 approximately 300,000 new businesses were created each month.5 This is about 3.5 million businesses per year—way more than the 1 million new starts counted by the Small Business Administration (SBA). The Business Formation Statistics (BFS) may itself underestimate the true number of annual business starts because it is based on the number of requests for new Employer Identification Numbers (EIN) from the IRS, and many episodic entrepreneurs, such as those selling products on eBay.com, simply report tax information using their own personal Social Security numbers.

When to Consider Part-Time Entrepreneurship 5-2 Describe the conditions that make part-time entrepreneurship a good decision. Many people assume that the one best way to go into business is to first write a detailed business plan, second raise capital, and third go into business full time from the start. In fact, this is exactly how most college courses in entrepreneurship present the process. There are good arguments for this approach to business entry, including the amount of thought and planning required to write a business plan, and the importance that angel investors, venture capitalists, banks, and other investors attach to a well-prepared business plan. However, starting or buying a full-time business entails a major commitment and is not always the best way to go about becoming an entrepreneur. And if you are not going to start a full-time business or ask other people for funding, a traditional business plan may not be needed. There are four types of situations in which it makes good sense to first undertake a part-time business (see Figure 5.1). The first situation is where you are new to business in general and need to gain basic experience. If you have not been involved in pricing, buying, and selling, learning how to do

such things makes a lot of sense before launching the business of your dreams. You might want to obtain other types of experience before starting a full-scale business or writing a business plan. These can include experience in the industry, in the line of business, in the locality of the specific market you plan to serve, in managing cash, or in managing yourself in self-employment. FIGURE 5.1When to Consider a Part-Time Business Page 123 A second type of situation is one in which you lack the resources necessary to pursue a full-scale business or create a business plan. Time is probably the ultimate resource, and starting a business can tax it heavily. Estimates suggest that developing a business plan may take anywhere from 50 to 200 hours or more if you are new to business and working on your own.6 Starting a full-time business can easily take 70 hours a week or more in its early stages. You might not be able to commit the time to work that many hours, so taking an easier path makes a lot of sense. Start-ups and purchases of full-time businesses also require substantial financial resources. When money is limited, starting out part time can greatly stretch those resources. The third type of situation is a narrow window of opportunity. For example, when teams are announced for tournaments like the NCAA Men's Basketball Tournament, there is suddenly a veritable flood on eBay of logo clothing and memorabilia from the selected teams. These eBay entrepreneurs are capitalizing on the increased interest in the newly announced teams. Within a few weeks, most of the selected teams will have lost and left the tournament, but in the meantime, they (and anything with their logo on it) are hot properties. Part-time businesses can generally be created quickly. When the business situation does not allow enough time to do a business plan, pursuing a part-time business is often the only profitable way to seize the opportunity. The fourth situation arises when you are uncertain about the demands of going into a full-time business. You may be concerned about whether or not you will actually like doing the activity as a business. As an example, Carla Brauer ultimately decided that she preferred being her own boss and creating a business was preferable to continuing to work as an employee. For her, the rewards of being in business make the demands of the business worthwhile. LEARN MORE ONLINE Learn more about the topics above at these sites: Quitting Your Job to Start a Business: www.entrepreneur.com/article/312133 Quitting Your Day Job or Keeping It: www.inc.com/melanie-curtin/should-you-quit-your-day-job-this-study-of-over-5000-entrepreneurs-has-a-surprising-answer.html

What Kinds of Part-Time Entrepreneurship Exist? 5-3 Describe the kinds of part-time entrepreneurship that exist. In this section we will look at the kinds of part-time small business that exist in most industries—retailing, wholesaling, most services, and even manufacturing (because most part-time manufacturing is based on either an artisan's small-scale production of products or on subcontracted manufacturing). How do we know

what are the most popular industries? Knowing that small businesses range from 97 to 99 percent of nearly every industry, a quick look at the number of firms in each can give us an idea. We can see a listing by industry in Table 5.2. TABLE 5.2 Size of U.S. Industries by Major Sector, Preliminary Data Third Quarter, 2015Table Summary: Table divided into four columns compares business sectors based on their size and total organizations. The column headers are marked from left to right as: NAICS sup asterisk; industry; number of establishments; and percentage. NAICS* Industry No. of Establishments Percentage 54–55–56 Professional & Business Services 1,739,828 19.1% 61–62 Education and Health Care 1,593,913 16.9 44–45 Retail Trade 1,047,401 11.5 81 Other Services (except Public Admin.) 829,262 9.1 71–72 Leisure and Hospitality 810,186 8.9 23 Construction 770,310 8.5 42 Wholesale Trade 624,052 6.9 52 Finance & Insurance 479,761 5.3 53 Real Estate, Rental, Leasing 369,802 4.1 48–49 Transportation & Warehousing 238,619 2.3 31–33 Manufacturing 342,991 3.8 51 Information 154,006 4.1 11 Agriculture, Forestry, Fishing, and Hunting 102,293 1.1 21 Mining, Quarrying, and Oil & Gas Extraction 35,942 0.4 22 Utilities 17,595 0.2 Total 9,101,961 ≈100% *NAICS = North American Industry Classification System. Source: U.S. Department of Labor, Bureau of Labor Statistics, "Industries at a Glance," www.bls.gov (accessed March 18, 2016). Special tabulation of the preliminary data third quarter by Richard Green. As you can see fromTable 5-2 it is possible to have a part-time business in any industry, from accounting to zookeeping. Certainly, part time is more common in some industries, such as retail sales, than it is in others, such as mining or quarrying operations. Because of this, the rest of the chapter will be concerned with the common forms of part-time business, and not with specific industries. The most common forms of part-time businesses are: Home based. Internet informational websites. E-commerce and eBay websites. Home retail (home party, door-to-door selling, network marketing, stands). Pop-up. Mobile offices. Virtual offices, executive offices, and incubators. Consignments and agents. Page 124 Home-Based Businesses Most part-time businesses start where you live—your home or dorm room—so home-based business is where we will start. The nature of part-time start-ups has changed in the past few years. Not so long ago, home businesses were strongly discouraged, if not outright banned in most towns and cities. The perception was that the increased traffic of a home-based business lowered the livability of residential areas. But this has changed because of increased use of the Internet as a source of information and as a method of communication. Today if you are trying to market beyond your immediate family, neighborhood, or circle of friends, you need to start your business with a web presence. Some businesses can in fact be done entirely on the web, and informational and e-commerce websites are the second and third business forms we will consider. The fourth start-up approach is a collection of other fast, low-cost approaches that can be helpful in a variety of situations. If you are looking for more ideas about the ways you can get started,

consider jumping ahead to Chapter 11 which discusses some of the more involved techniques such as direct mail, telemarketing, and direct response advertising that can be used in particular situations for a part-time business. • This is close to an ideal setup for a home office. There is space for files and equipment. The owner has the equipment needed to do her work, and there is a door to provide some quiet and privacy, but the glass lets her see what is going on at home, and lets her family know she is around. Brand X/JupiterImages/Getty Images Home might be where the heart is, but it is also where the part-time business starts. If yours is a retailing or wholesaling business, home is where you store your goods. If you are making furniture, toys, clothing, or food, it is probably where your work area is. And if you are in a service, it is where you retire to in order to get your work done. For nearly everyone, home is where you keep your office records, do your bookkeeping and taxes, and where you probably first receive your firm's mail. You may work away from home: In a section on location in Chapter 11 we consider service firms where you do part of your work at the client's location or at remote locations, but unless you get an office or other location from which you will base your business, you will probably start from home. Page 125 There were about 9.0 million home-based businesses in the United States in 2012,7 and they represented 33 percent of all firms. The reason for these large numbers is that the home-based business meets at least two of the three criteria for start-up. It is inexpensive, since you are already living somewhere and you can quickly get your business going where you live. Although home-based businesses do not always give customers the strongest sense of legitimacy, the idea that a customer knows where the entrepreneur lives can be a point in favor of trusting in the potential permanence of the firm. That said, with so great a number of firms, there are not many hard-and-fast rules that apply to everyone, but there are a few key ideas to keep in mind.8 First and foremost is the location of your home-based business. Although the dining room table may be infrequently used, is it the best place for you to work? Even though anything can work, the following suggestions come from home-based entrepreneurs and are likely to make your life a lot easier. According to home-based entrepreneurs, the greatest problems they face come when there are zoning challenges or family challenges to the business. Cities, counties, neighborhoods, apartment complexes, and dorms pass regulations that limit the ways residents can use or modify their space. The government restrictions are called zoning laws, while the ones set up by other organizations are called covenants. Unfortunately there is no comprehensive free online national listing of zoning regulations,9 but there are public records, and these can often be found online on your city's or county's government website. Otherwise, the local chamber of commerce or the local library may have the basic information. It is best to carefully check out the zoning and covenant situation before fully committing yourself to a home-based business. Most of us live in areas zoned as residential areas. Typically, it is not legal to have a home-based business in a residential

area—even an online business.10 It may be tempting to simply ignore such restrictions. Doing so, however, raises ethical issues and may cause the imposition of fines and penalties on your new business. Usually people get into trouble only if a neighbor, landlord, or dorm staffer complains or it becomes apparent to police or other public service employees that "something" is going on at your home. In either situation, what causes the problem, and makes it stick, are aspects of your business that "change the residential character of the neighborhood" through increased traffic, noise, parked cars, or smells. To minimize problems, there are several alternatives.11 If you are not concerned about the ethical implications, you can generally keep the web- and phone-based aspects of your business at home without neighbors becoming aware of (or disturbed by) your business—but be sure not to tell them you work from home! The way to handle large amounts of mail and packages is through the use of private mailboxes (from a company like PakMail, Mailboxes Etc., or Postal-Annex) and self-storage facilities (like Public Storage U-Haul, Storage USA, or similar local companies), rather than having them delivered to your home. Use the private mailbox address for your business on the web and on your stationery. Another approach is to get permission—called a variance—to have your business operating from out of your home. Often there are local lawyers who specialize in real estate and zoning law, and they can advise you if a variance is a workable solution. While you can request a variance on your own, having a lawyer advocate for you can cost from hundreds to thousands of dollars, so this approach is only for those with determination and money.12 The best way to find such a lawyer is through referrals from friends or businesspeople whose judgment you trust. If that does not work, or you want to check into the lawyers suggested to you, you can use an online directory such as Martindale.com or FindLaw.com to find and learn more about local lawyers. Page 126 Once zoning is handled, think about issues inside your home. The following list touches on many of the issues home-based entrepreneurs find most important to running their business: Choose a work location inside your home that is away from noise, distractions, and family traffic. It helps you concentrate and sound businesslike when on the phone. Be realistic about the amount of space you'll need for your equipment. An office door can keep business separate from family and the rest of life. Try out your location for a day or two to check out noise, traffic patterns, lighting needs, and distractions. Don't overload on hours of work, or on snacks from the refrigerator down the hall. Set up your workday to minimize distractions from household or family chores and, as much as possible, stick to the plan. Consider hiring help to handle household or family chores to free up your time. Set the ground rules early and stick with them. Watch out for family, friends, and visitors who don't understand home-based businesses. When you run a home-based business you will find that working-outside-the-home parents, siblings, children, and friends don't understand that they can't drop off their ill or vacationing children so that they don't miss

work. You'll be asked to do extra school or sports carpools, wait for service people, or other such things because of your at-home status. • One of the greatest challenges to making a home office work is getting family and friends to give you the privacy and time alone to do the work you need to do. How could this father have avoided this situation? JupiterImages/Getty Images Exhibit 5.1 summarizes the five most important issues that you should think about before you set up a home-based business. Once you've chosen your location, you'll need equipment. You'll need a comfortable, usable desk and chair and adequate lighting. Consider the tasks you'll perform most frequently and check out the ergonomic options that will serve you the best. Although you can store files in cardboard boxes, an inexpensive filing cabinet would be so much simpler. Think about the layout of the furniture for access to proper lighting, phone jacks, and electrical outlets. You may need to supplement some or all of these. EXHIBIT 5.1Essential Questions to Answer for a Home Office If you intend to deduct the expenses of your home office, can you comply with the regulatory standards? Home office space must be regularly and exclusively used for business—no letting your preteen daughter use it for a weekend sleepover! The home office must be your principal place of business, unless it is a freestanding structure such as a detached studio or a shed. To be allowed to deduct home office expenses you must keep detailed records as listed in IRS Publication 587, Business Use of Your Home. If you are going to use a home office, can you meet state, county, and municipal regulations? Zoning must allow for home-based businesses. If you use your home for producing, storing, or distributing any food or medicinal products you must conform to health, environmental (temperature and humidity), and safety regulations. You will need to meet minimum standards for handicap accessibility, fire prevention, and liability insurance. Home-based business are subject to the same licensing and inspection rules that apply if you have a remote location. If you choose to have a home office, can you be productive in that space? Interruptions from family members, neighbors, and pets must be kept to a minimum. Distractions such as windows that overlook areas of high activity, television programs playing in other rooms, and squabbles among your children should be avoided. You will need comfortable and sufficient work space such as a desk or a table. You will need adequate storage, such as a fireproof file cabinet, for records and other documents. In today's business world secure high-speed Internet access is essential. Dial-up will not do. You may need space for an administrative assistant or other full-time help. Will you be able to deal with clients, vendors, or employees in your home office? A home-based business that deals with clients, such as an accounting, counseling, or therapy practice, should have a separate entrance from the one your family uses. Unless you are 100 percent efficient in scheduling appointments, you will need an area where business visitors may wait comfortably. If your home-based business requires team effort, you will need provision and space to hold meetings. You must be able to meet minimum parking space

regulations. Many cities stringently restrict on-street parking. Will you be able to separate home and business life? Home offices provide great temptation to devote all your time to work because they are “right there.” It can be very difficult to discipline yourself to keep regular office hours. Spouses, children, and friends all have difficulty realizing that when you work in your home office, you really are working. Tools typically include a telephone (these days most often a cell phone), high-capacity Internet service (like cable or DSL or 5G Wi-Fi service for your laptop), a business email account, a high-speed desktop computer, a fax machine, a copier, and appropriate software (see Table 5.3 for high-quality free programs and services). These days many multipurpose devices combine a printer, copier, fax machine, and scanner into one piece of equipment, which reduces the amount of space you’ll need. Consider the layout of the equipment and how you’ll use each piece. You don’t want to reach around your computer monitor to pick up the telephone or race across the room to catch printer pages. TABLE 5.3 Essential Free Software and Web Services for Small BusinessesTable Summary: Table divided into three columns summarizes list of tools and services based on business type. Column 1 notes the list of business sectors. Columns 2 to 3 are marked as: open source sup asterisk and web based. Open Source* Web Based Basic business suite (like Microsoft Office) Openoffice.org; Libreoffice.org Zoho.com (has CRM and other modules) Thinkfree.com Project management (like Microsoft Project) Projectlibre.org Freedcamp.com Trello.com Email (like Outlook) Mozilla Thunderbird Zimbra.com Knowledge management (like PeopleSoft) www.bitfarm-archiv.com/ Mediawiki.com Customer relationship management (CRM) SuiteCRM.com Freecrm.com Social networking Elgg.org LinkedIn.com Financial projection creation Exl-Plan Free, www.planware.org/exlfree.htm SBA.gov/tools/business-plan Accounting program (like QuickBooks) Grisbi.org Waveapps.com PDF file creation (like Adobe Acrobat) OpenOffice or PDFCreator, www.openoffice.org/; www.pdfforge.org/pdfcreator Pdfonline.com Desktop publishing (like Adobe PageMaker) Scribus.net www.fatpaint.com Paint program (like Adobe Photoshop) Getpaint.net; Gimp.org Ipiccy.com *All open source software offers versions that will run under Microsoft Windows. Many offer support for Macs and other platforms. Page 128 You’ll want to have a separate business telephone line with an answering machine, voice mail, or virtual PBX service so that you can get those important calls after hours. Make sure your voice-mail message sounds businesslike and not like the message on your home answering machine. Consider a second phone line if you are limited to a modem-based Internet connection. Ideally, this space and its tools will be used only for your home-based office. In addition, totally separate space and equipment make tax deduction preparation much simpler. • Sometimes the success of a home-based business is what makes it necessary to move. This part-time entrepreneur’s business completely overwhelmed the downstairs den. What started as a home office in the corner grew until it became an office

warehouse and shipping center. How do you think her family is responding? Paulaphoto/Shutterstock When does a home-based business outgrow the home? For some companies, the answer is never. Some entrepreneurs opt for charging higher prices for their goods or services or limiting their sales so as not to outgrow the space available; being a home-based business is just too important to them to change. Others reinvest their profits into additions to their homes to accommodate their business growth or to upgrade to a roomier house with the extra space they need. Some die-hard home-based entrepreneurs faced with this decision have found creative ways of housing their staff and other operations in an outside office while continuing to telecommute as much as possible.13 More typically, a business will find the need for meeting rooms and employee accommodations or zoning restrictions will force the change. In other cases, family situations just aren't favorable to a home-based business. Some entrepreneurs find they aren't cut out for the solitude of working by themselves or find household chores, family, or other distractions disturb them too easily. Home-based business is the easiest and fastest way to start a business, and the easiest and fastest type of business to move or close down. This ease of deployment, moving, and closing make the home-based business one of the volatile forms of part-time business. Even so, it is the core and greatest common factor in business start-ups. Page 129 Internet Informational Websites14 Perhaps the biggest change in part-time self-employment in the past five years has been the growth of the Internet as a major method for conducting business. Most of us have bought something online, which is what is called e-commerce. But another type of website, the informational website, is an even more important type of site that informs possible customers about your firm. For a part-time entrepreneur, a website can become a 24-hour-a-day, 7-day-a-week source of information and prospects, if not sales. To get some idea about the power of the Internet for information and for e-commerce, consider this. Google now reports that it receives 40,00015 searches per second worldwide. This calculates to over 1.3 trillion searches per year. Another way to look at this astounding number is it is equivalent to 187 searches made for each person: women, men, girls, and boys living today! The U.S. Census reported that e-commerce sales in 2018 were about $504 billion. This is more than 9 percent of the total retail sales reported.16 But even this figure understates the real level of e-commerce sales. As David Evans et al. report, because of the way the Census Bureau calculates e-commerce totals, actual online retail sales are most likely understated, but by an amount that cannot be reliably estimated.17 Products like music and cell phones are examples of the kind of goods we buy as individuals. That type of e-commerce is called business-to-consumer (B2C). There is another type called business-to-business (B2B) sales where one firm sells to another firm. While our personal experience is in the B2C marketplace, all of those sales on iTunes, eBay, Amazon, and the thousands of other online merchants account for only about 10 percent of all retail sales in the United States. For

most of us, the B2B market is invisible, but when businesses buy, they buy big. In 2013, over 61 percent of all manufacturing sales were handled online as well as almost 47 percent of all wholesale trade between businesses.18 You can see the difference, and the growth of these forms of e-commerce, in Figure 5.2. The moral of this story? B2C e-commerce is large, B2B e-commerce is larger, but using an informational website to inform customers—whether they are individuals or businesses—is huge and getting ever bigger! We can only guess what the percentages may be today. FIGURE 5.2E-commerce as Percentage of Total Sales 2002–2013 Source: U.S. Census Bureau, "U.S. Census Bureau 2012 E-commerce Multi-sector Data Tables," released May 22, 2014. The Internet's power comes from its being a very cost-effective and efficient way to contact your customers. With the Internet, a small, part-time, one-person operation can compete with a billion-dollar-a-year multinational. Whether your customers are other businesses or other consumers, getting a website together is essential. Page 130 Most small businesses—even part time ones—need to have a website regardless of whether they use it for actual sales. First of all, potential customers will use it to find you. Second, if they've heard about you from something other than the Internet, they will use your site to find out more information about you and to decide if they want to actually contact you. Letrah International, a firm specializing in international consulting for design and engineering projects, knew it should have a website, but it was a low priority and was worked on only when something else did not come up. Dave Peters, the firm's vice president at that time, asked a firm in the United Arab Emirates if there was anything he could do to help convince the firm to accept Letrah's bid. The firm expressed concern that Letrah was not a real company because it didn't have a website, and "everybody knew real U.S. firms had websites." The website was running the following day.19 Letrah was able to develop and deploy an informational website in a matter of hours. That is not uncommon. The basics of an informational website can be set up within an hour. There are a number of very low-cost vendors, such as 1&1 IONIS (ionos.com), SiteBuilder.com, and GoDaddy.com, as well as the major web presence providers like Yahoo! and Google sites (just search Google for "cheap websites"). What you are looking for in a basic informational website package is a domain name of your own. Ideally you want your business's name in the domain name of your site. If you want to call your company Beachcomber Shoes, you would ideally look for the domain name beachcombershoes.com. If the dot-com version is not available, using .net or .biz, or .us might work for you. Otherwise you can tweak the domain name—for example, beachcombershoecompany.com or beachshoes.com. You want a name that reinforces your firm's name or your product's name, or something highly memorable, like ouch.com. Note that the price of domain names varies. An unregistered name is about $35 a year retail, but most of the discount website providers will charge as little as $10 a year, and some will include it for free when you buy a website (what they usually call a "hosting")

package. Page 131 A hosting package for an informational site should include at least 1 gigabyte of traffic a month (this refers to people downloading your pages into their browser). It should give you at least 10 web pages of space to tell your story. It should also include templates to help you develop a website that has a professional look and an online website editor so you can make changes to your site without buying web-authoring software. The hosting package should also include at least five email accounts using your domain name (e.g., info@beachcombershoes.com, support@beachcombershoes.com, jane@beachcombershoes.com, etc.). While using Beachcombershoes@gmail.com (which is a free email service from Google) is good, having info@beachcombershoes.com is even better. The material for your website can come from promotional material you have written. Every page should have the company name, your contact information (or a link to it), a site map link (which shows a directory of all your pages—don't worry, the template should generate this automatically), and a link back to the home page. Typically your home page (the first page people see when they type in your domain name) gives a quick (one or two paragraphs) introduction of the company and should prominently display your product or service. Other typical pages include: "About Us," which gives a brief background on the company and you. Product or service pages, which give a more detailed description of what you sell or what you do. Support page, which gives customers or potential customers information on how, and reassurance that, their problems with your product or service will get solved. Resources page, which typically gives general information (e.g., "Five things you should know about buying _____"). Press or media page if you have received notice in the media. Today many informational websites include the capability to add a blog, which is a web page in which entries are posted in reverse chronological order (i.e., the most recent at the top of the page). Many blogs let readers respond online, so the entrepreneur and the potential customers can interact directly. Today website packages include the ability to push content, like your blog, out to customers who register at your site. Some sites do this by using an RSS feed. RSS stands for "really simple syndication" and an RSS feed pushes or sends whatever web material you specify to subscribers to that feed. RSS feeds can be read in many browsers or with special readers. A similar approach uses an email mailing list to send emails or online newsletters (sometimes called e-newsletters) to people on your subscriber list. To read these, subscribers have to use an email program or a browser. Many web hosting packages offer a mailing list program as part of the package, but there are also for-fee specialized mailing list programs with more features, such as ConstantContact.com. The latest variation on push technology is Twitter.com. Twitter is a free service that lets a person send a 140-character-or-less message or tweet to people who subscribe to the person's Twitter account. You can see what Oprah is up to, or check out StockTwits.com, which uses tweets to inform members about up-to-the-second trends in the stock market. Realize that while you can design your own site, there are also a lot of

people who can do it for you, from your “techno-geek” teenage nephew who will do it for the cost of the latest computer game to firms that will not only design but also maintain your website for you—at a cost, of course. You can also hire professionals to set up and manage a site for you. Do a Google search for “managed e-commerce solutions.” There are volumes and volumes written about what things to consider when building your website. You probably have your own list of pet peeves about things some websites do that drive you crazy. That list is what you need to make sure your website does not have those elements, which probably include: Slow-loading graphics or pages. Too many layers of screens to get to what you want. Dead links within the website (when you see a “404 error”). Hard-to-fill-in online forms. Pop-up ads. Pages that look or work “right” only in one type of browser. Page 132 But you are likely to have many other complaints. The trick is to think of them before you deploy your website, and you’ll make your customers and prospective customers happier. Once you’ve got your website up and running and it is a masterpiece in design, how do you get your customers to find it? The first way is multichannel marketing. Have your website listed on your business cards and every piece of paper, advertising, and the like. The second and equally important way is to get linked to other web pages. If you were in the target market for your product, what web pages would you visit? Figure out what these are and establish reciprocal links. In a reciprocal link, you display a link to another website and that website displays a similar link to yours. Scan chat rooms and other electronic message boards to see if people are looking for your type of product or service and post your website. Discover what sorts of electronic newsletters they might read and get a mention in them.20 The third way is online searching. Searching online is how about 85 percent of Internet users find websites, but users will seldom go beyond the first couple of pages of a search.21 There are several ways to get your site positioned so that a person searching is likely to see it. The technique, which is free, is called search engine optimization (SEO) and refers to designing a website so that search engines like Google, Bing, and Yahoo! are likely to rank your site high (closer to the first listing). Many web hosting packages include programs to help you edit your website to improve your ranking. There are also books on SEO and websites like SearchEngineGuide.com, SearchEngineWatch.com, and SubmitCorner.com that are devoted to telling you the hundreds of secrets to mastering SEO. If you are willing to put up some money, you can pay for sponsored links (guaranteeing you a particular placement on the first page of a search) from the search engines at a manageable cost. Google and Yahoo! ask you what word you want to use and how much you are willing to pay (our suggestion is start with a low number). You then find out how often the word is used, and how often a searcher clicks on any sponsored link. Paying more will get your sponsored link closer to the top of the page. You can make multiple offers until you find one you can live with.22 The problem you might face comes from what you sell. If you are a bookstore, the word “books” might come to

mind, but that's true for lots of other bookstores, publishers, and other companies. Maybe "first editions" is more appropriate, if that is indeed what you sell. On the other hand, if you sell something a bit more unusual like yo-yos, buying a sponsored link for "yo-yo" is likely to get you on a page with limited competition.23 Watch for jargon; think of what the average searcher might enter. Your hosting service's SEO program or your own web page designer will understand where to place the keywords you select and can help you get listed on the major search engines. There are literally hundreds of search engines, but there are five major ones—Google, Microsoft Bing, Yahoo!, Ask Network, and AOL. The next six largest search engines share less than 1 percent of the searches. You can see their relative shares of the search business in Figure 5.3. FIGURE 5.3Search Engine Rankings—February 2016 Source: Data from comScore Releases, February 2016, U.S. Desktop Search Engine Rankings. Page 133 With all of these details revolving around making a truly effective informational website, you may wonder if it makes sense to do it yourself. As we have discussed, many $10-a-month web hosting packages will give you access to the tools to create a basic template-driven website and do the work necessary to perform SEO and will push your information to others via emails, RSS feeds, or Twitter tweets. The advantage is that you can deploy the site within hours and the cost is very low. The downside of template-based sites is that they can look similar to one another. On the other hand, having an e-commerce website created for you can be a $5,000 to $10,000 effort, and is likely to take a couple of weeks as you and your designer talk through draft versions of the site. One way to strike a balance between these two extremes is to commission custom graphics to use at the top of your online store's pages, and as a background. Another approach is to seek bids for your e-commerce store design on sites like Upwork.com or from local web designers. For many part-time firms, an informational website is the essential starting point to get word out to the public, and to make your firm visible to those Internet search engines so many people use to find companies, goods, and services these days. Often, as the firm and its offerings mature, there is a benefit to moving beyond providing information via the web, and making it possible for customers to actually place their orders online. That takes you to the next step, e-commerce. E-commerce and eBay Websites How big is e-commerce and how fast is it growing? As noted earlier, there is a growing use of the Internet for e-commerce. The number of e-commerce sites, shown in Figure 5.4, passed 1 million in January 2009 and is estimated to be greater than 2.5 million today. Figure 5.2 showed how e-commerce sales were growing at a steady pace for B2C retail and wholesale sales, and growing at a much faster rate for B2B wholesale and manufacturing sales. E-commerce in 2013 was more than a $5.6 trillion sector of U.S. business.24 So the answer is that e-commerce is big and getting bigger. For part-time entrepreneurs, the lure of an e-commerce site is undeniable. Consider listing your products on the top two sites. There is no official count of eBay sellers, but Savanna Dance

wrote in a user group posting that active eBay sellers number between 6.7 and 9.3 million in the United States alone.25 Seven out of every eight sellers work on eBay only part time. The cost of listing a $25 item on eBay is $1, plus an additional 8.75 percent of $25 if the item sells. The cost to open an eBay account? Nothing.26 eBay's biggest competitor, Amazon, offers a similar deal with slightly different terms. Between the two sites, nearly a half-billion computer users visit one site or another during the year. FIGURE 5.4Growth of E-commerce Sites Source: Numbers of Secure Sockets Layer (SSL) certificates issued since 2009 calculated by Richard Green from graph of percentage increase: http://news.netcraft.com/archives/2015/05/13/counting-ssl-certificates.html (accessed March 12, 2016). Page 134 With numbers like those it is no wonder that e-commerce on the Internet is an attractive approach for entrepreneurs looking to create a business. This is especially true for part-time entrepreneurs. For part-time entrepreneurs the online approach makes a highly attractive opportunity because it offers the advantages of a large market, 24/7 availability of your products, and a start-up that is quickly done and potentially inexpensive. For many part-timers, the online approach provides a great way to learn the business and the market, establish your reputation and business track record, and lay a foundation for a full-time business. For entrepreneurs looking to prospect for the right type of business, the online sales approach makes it possible to try out a range of industries quickly and with minimal risk. For entrepreneurs with highly specialized products, the idea that low-cost listings on two sites could reach half of 1.1 billion Internet users worldwide27 opens up sales possibilities like never before. There are two major approaches to online selling. One is using Amazon, eBay, or another online site to showcase your goods and handle the selling and payment process. The other is to do this through a website of your own. The two approaches can be complementary. You can use eBay to introduce your product to a large audience, to find an initial selling price, and to learn more about customers and competitors. Once you are comfortable with how you must market your product, you can set up your own website as the primary point of sale and continue to use eBay to market to new customers. Everything we have said so far about informational websites applies to a website enabled for e-commerce. Most of the hosting companies mentioned in this chapter can also provide you with an e-commerce site. In fact if you already have an informational site, they can set it up so everything you have posted to the web moves directly into the new, more capable site. What e-commerce sites add is the ability to create and maintain an online catalog of products, create new database entries for orders, and handle the payment for products or services. The more tools and services you need and the larger the catalogs you post, the more you will end up paying. It is worth doing some serious comparison shopping for hosting services. Conduct a Google search for "cheap e-commerce" and "free shopping cart" (a shopping cart is the electronic version of a catalog with an ordering system) to find a large number of

possibilities. Many offer do-it-yourself software to make the design of websites and shopping carts easy. In addition to the keys to designing an effective informational website covered previously, there are also two important financial issues to consider for entrepreneurs who create their own e-commerce websites: payments and chargebacks. Payments: Most online transactions use a credit card or an online payment system like PayPal (which originated as a division of eBay). There are fees for the transaction itself, and there are often fees for currency conversions, or guaranteed payments. Unless you as the seller buy a payment guarantee at the time of the transaction, services will also make a chargeback (see the next bullet point). Many online e-commerce packages come with a service that handles these transactions for a fee. Where you can specify another vendor, you may be able to get one that charges less. But as important as the fees charged is the service's handling of customer service. When problems crop up in payments, both buyers and sellers want to talk to a person immediately. Services with fast response rates and helpful people on the phone are valuable. Chargebacks: This is a fee the service charges you for any of a variety of problems related to the sale—for example, a lost, stolen, or fraudulent card was used, the customer reports nothing was received, the product was not the one promised, or there were problems with the product. While chargebacks in stores are around 0.1 percent of sales, online chargeback rates can be as much as five times higher.28 Techniques to control this include using the Address Verification Service or verifying phone numbers or addresses yourself, getting proof of delivery from the carrier, and making sure your return policy is known by the customer before the sale is finalized. Page 135 eBay is a site offering a variety of ways to sell goods and services. To give you an idea of how varied are eBay's offerings, consider these ways eBay supports entrepreneurial efforts: For many interested in selling only a few items and moving to something else, eBay is like the largest consignment store or garage sale in the world. You can list a single item for sale without creating a website or a company to support your effort. You can create an online store within eBay complete with your own online catalog and ordering systems. eBay has 34 major categories of goods ranging from "collectibles," which includes the Pez containers many erroneously believe were eBay's first items, to "Business & Industrial," where you can buy 75-ton construction cranes. You can sell services through Upwork.com ranging from web design to business plans, accounting to translation, training to CAD projects, in a reverse auction format. In a reverse auction29 the low bid gets the business. Upwork.com adapts the eBay model to services. Businesses post projects, review bids, use the message boards to keep up-to-date, and can even pay online, all for a small fee Upwork collects once the provider is paid. Service providers are able to post information about their expertise and experience as well. Cheri Rychlee Tracy was looking for a web designer. Local companies wanted between $1,500 and $7,500. She was able to find a freelance designer on Upwork from the Ukraine for $750.30 • This entrepreneur is taking

no risks with her product sales on eBay. Not only is she checking her product's listing for prospective buyers, she is also checking how her eBay online store is showing up in social media like Yahoo!'s groups and a set of photos of products she has uploaded to Flickr. John Flournoy/McGraw-Hill Education While this section concentrates on eBay, it is important to know that there are competitors for every type of service eBay offers. Their traffic numbers may not match eBay's, but they may have a better audience for your purposes. For example, freelanceseek.com has a strong programming and online art focus, and is a site often used by people in the e-commerce industry. Competing sites include: For Upwork: Freelancer.com, Seek.com. For eBay's B2C auction services: Auction.com, Ioffer.com, uBid.com. For eBay's B2B auction services: Business.com. For eBay's online store services: Amazon.com, GoDaddy.com. Using e-commerce services like eBay or Upwork can provide access to a wider range of vendors or service providers than most people would normally have. And many of the online services like eBay, Upwork, and Amazon provide detailed feedback and ratings from prior customers, so as a buyer you can have a higher level of assurance that the online company you are dealing with is on the up and up—but problems can crop up. Two of the greatest ones for vendors—chargebacks and payment problems—were mentioned. A customer can also face trouble, as seen in the following Small Business Insight. SMALL BUSINESS INSIGHT My People Might Destroy Your Website Henry Richardson was a professor at a small college and had an active consulting business. A lot of the materials he created for individual clients he rewrote in a more general form and sold as pamphlets, short reports, and self-published trade books. He had an informational website, but as the technology advanced he realized he could cut his production costs dramatically by selling his pamphlets, reports, and books as downloadable PDF files. To control this process he needed a different type of online store—one specialized for the electronic publishing industry. Such programs not only handle the order, but also control the downloading of files so that only bona fide customers can obtain the download. Not finding any electronic publishing sales packages he liked, he decided to have one custom designed. Henry went onto Elance.com (now called Upwork.com) and put in a request for bids for his project. From the 23 responses (ranging from $11,800 to $450), Henry narrowed the field by looking at the customer ratings, track records, and portfolios of the companies. His chosen company had an American sales office and a team of programmers in India. Henry thought this would help provide better coordination for the project. The final negotiated price was $1,800. Although the project was supposed to be completed in three weeks, Henry never heard from the U.S. or Indian offices, a definite bad sign. Henry got a call from the U.S. sales office in week 4 stating that the project was behind schedule but would be finished "soon." Excuses piled on for two more months. At the end of month 3, Henry sent an ultimatum to the vendor—finish the project or return the money. This initiated a call from the Indian office. The company's manager said because

they had done “work” on the project, they would refund $1,200, but only if Henry would give a positive review for the firm on Elance! When Henry asked what would happen if he gave an honest rating, the manager said he did not know how his programmers would take such an insult. They might just destroy Henry’s existing informational website out of anger. Not wanting to spend his days protecting his website, Henry agreed. He later had a local programmer do the site for $4,000. Page 136 People who sell on eBay or competing auction site stores strongly suggest using the auction feature; after all, that is what most people think of when they go to the site. Sherry Chase of Fancy That! started an eBay store as a means of getting rid of excess merchandise from her store. She had tried her own website with virtually no luck at first. She found that eBay sales exceeded her expectations. She also found that by auctioning items and including her link in the auction description, she got people to her eBay store.31 eBay auctions themselves are legendary. On any day 12 million items are available with nearly 2 million new postings a day.32 There are 150 new items for sale listed every minute, and 500 bids placed during that same minute. There are 69 million eBay users who spend $59 million a day.33 The eBay method means you pay a fee for posting your product and a sales fee based on the final bid price when the item sells. You have the option of setting a bottom offer you will accept, a reserve price (if the bidding does not exceed the price, the sale will not go through), and the number of days the auction will run (out of several choices). Your posting can include pictures of the product and links to more data (like your website). eBay allows you a bit of anonymity—all buyers and sellers have screen names. Email addresses and limited personal information are given out only in certain circumstances. (Obviously, if you are a successful bidder, the seller needs to know to whom and where to send the merchandise.) eBay sellers may take checks, money orders, or credit cards, or accept payments through PayPal, eBay’s own electronic payment system, reducing sellers’ risk. eBay also allows buyers and sellers to post feedback about their transactions which produces a score that’s displayed by the buyers’ and sellers’ screen names and allows others to get a feel for how reputable a certain buyer or seller is. This feedback is also available for the public to read. (See Skill Module 5.1 for more tips.) SKILL MODULE 5.1 Checklist for Maximizing Success on eBay34 There are whole books written on how to do well on eBay, but what are the basics that can make the biggest difference? As you prepare for selling via eBay, test your ad and your approach to eBay selling against the checklist below. DESCRIPTION Detailed Description? Use detailed descriptions so that the buyer isn’t expecting something different from what you are selling. Typpppos? Watch out for misspellings and typos. Experienced eBay buyers use the search engine to find specific things and it won’t find your misspelling. Besides, it doesn’t look very professional. Factual Bad News Up Front? Be honest and factual. Don’t say “slight damage.” Instead state that there is an 8-inch chip on the upper right-hand corner and a faint scratch along one side. The buyer can make an informed decision, and there are no

surprises. Got a Positive Feedback Rating? Since most buyers are somewhat reluctant about buying from a seller with no feedback, try buying for a while; your feedback rating will grow, and since there is no differentiation between buyer and seller feedback, this puts you in a better position as a seller. PHOTOS Photo Present? A picture is worth a thousand words. Photo Pretty? Make sure the photo is not too dark or too light. Does it adequately display your product? Check out backgrounds, too. They can detract from the subject and might even show things you'd rather not display on the Internet. Photo Fast? Don't use huge slow-to-download files. Photo Real? Showing a photo of a box of commercial software is fine if that is what you are selling. If it is only the CD, without the box and the items included in it (like manuals, jewel cases, registration cards, etc.), it is better to take a photo of what exactly you are selling and include it on the eBay page. COMPETITIVE ISSUES Price-Matched the Competition? Check what the competition is doing to see if you even want to try eBay auctions. If your product (or something fairly similar) is selling on eBay for less than you need to meet your profit goals, find another way to get to your customers. Shipping Not a Rip-Off? Be honest and up front about shipping. It is acceptable to charge for postage and a reasonable amount for shipping materials. If you are using recycled boxes, don't charge for them. Some sellers like to use a flat fee for all shipping charges (e.g., $5 per paperback book). Experienced eBay buyers will know that for regular U.S. media mail, that price is way out of line. If you're the only one selling that item, consumers may pay; but if there are a dozen others, they will shop around or reflect their concerns in the top bid they place. Terms Match the Competition? When you find similar products being offered by competitors, make sure you have the same terms on your product page, so people searching on those terms find your page when they find your competitors'. Time Matches the Competition? If you are using auctions, try to time your auctions to end after your competitors'. Remember that most people will lose in an auction. If you are offering a similar product, which comes up on the same search with similar costs and closing right after an auction from a popular seller, many buyers will bid on your offering. SALES-RELATED SERVICES Email Ready? If buyers have a question, they'll email you. Respond as soon as possible, at least within 24 hours. Don't post auction items just prior to going on vacation. Shipping Promptly? Package well. Notify your buyers when things have been shipped. If you need to wait for a check to clear and you'll be gone a few days during that time, let them know. Most buyers are prepared to be reasonable if they know what's going on. Quick Customer Response? Customer service is very important. You want positive feedback. Dissatisfied buyers may either leave negative feedback or leave no feedback at all on your transaction. Gave Feedback Promptly? Give feedback to your buyers, too. First, it helps them when making further purchases. Second, if you expect feedback yourself, do it for them. If they see you've posted positive feedback, they are more likely to do so themselves. SCORING Score 1 for each Yes answer and 0 for each No

answer, then add up each category. 4 in a category is “Excellent,” 3 is “Adequate,” and 2 means “Needs Improvement.” A score of 1 or zero in any category is “Not Ready for eBay,” and you should hold off selling on eBay until you have raised your score in this category. Page 138 There are restrictions on the types of products that may be sold—for example, anything that is considered fraudulent, illegal, or harmful, as well as anything that infringes on patent or trademark rules. eBay does enforce this policy. For more detailed information about doing business on eBay, check the website www.ebay.com or look at one of the numerous books about eBay, such as eBay for Dummies. Although the web traffic counts for eBay and Amazon are extremely high, a wise entrepreneur (even a part-time one) does not rely on customer searches on these sites alone to bring in business. The most successful web entrepreneurs keep using the multichannel marketing approach introduced earlier. Getting the name of your online store into newsletters (electronic or printed), newspapers, trade journals, blogs, or on mass media (local can be just as powerful as national) can help you promote your site to potential customers. Increasingly, entrepreneurs are using the social networking sites mentioned in Chapter 3, like Facebook, Instagram, and LinkedIn, to get the word out to friends of your firm as well as potential customers interested in what you or your firm has to say. A quick listing of the other places to promote your site is given in Figure 5.5. Page 139 Figure 5.5 mentions a few other types of sites we have not discussed so far. These include free sites like the video site YouTube.com where you can post a video for free; bookmarking sites like Digg.com or Pinboard.in where you can identify websites and get these voted on or adopted by readers; and opinion sites where customers can post opinions about firms, products, and services. There is also a free way to get your name (and your business) known, and that is by making informed comments on blogs and discussion forums related to your business. FIGURE 5.5 BUSINESS PROMOTION MULTICHANNELS There are also several advertising channels that come with costs. Obviously, the traditional approaches to advertising, like business cards, stationery, printed newsletters, and brochures, cost money (although these days you can print just the quantity you need on a good color printer). There are also old media approaches that are still important. Local and national newspapers (like The Wall Street Journal) also have online versions (and online ads). The phone company’s local directories also often come with an online version. There are also many specialized online directories, such as those of the Better Business Bureau (www.bbb.org). Given the cost of getting into e-commerce, especially with sites like eBay, you can’t argue with the resulting success stories. Mark and Robin LeVine sell more than $1 million per year of bubble wrap and other packing materials. Sarah Davis sells over $4 million annually of designer handbags. Although “eBay millionaires” are a minority of eBay sellers, these two examples are by no means unusual.35 eBay is also successful for business-to-business selling, although it no longer maintains its business-specific pages.36 Farmer Joel Holstad purchased a tractor, a

combine, and a cherry picker for about half of what he expected to pay. Home-based business and Internet business are the two core methods of getting started for part-time entrepreneurs. They can cover a wide variety of retail, wholesale, service, and even simple manufacturing situations (like artisans' work or custom electronics), but there are other approaches that offer quickly deployed, low-cost ways to start part-time businesses. Sometimes these approaches are next steps for home-based or Internet businesses, but in other cases, these approaches can be the first step for a part-time firm. The Next Best Things to a Home-Based Business Often, business success depends on getting close to the customer—close enough so the customer can see you, the entrepreneur, your product, or you delivering your service. As you'll learn in Chapter 11, you can go to your customer (as in the case of a repair service which works at the customer's site) or you can go to a mutually accessible location, like a store. There are several approaches closely identified with part-time businesses. Historically, two methods have been mentioned most often—home retail (which consists of home parties, door-to-door selling, and network marketing) and stands or kiosks. Home Retail At a home party the entrepreneur arranges a get-together at someone's home where participants can socialize and get acquainted with the entrepreneur and the products or services offered. Home party selling was pioneered (if not actually invented) by Frank Stanley Beveridge and Norman W. Squires who began selling Stanley Home Products by enticing homemakers to invite a small group of family, friends, and neighbors into their homes for a party.37 At the party, the salesperson would demonstrate products and take orders for future delivery. Today this is a widely used technique with dozens of franchised sales operations for products such as Mary Kay Cosmetics and Tupperware. The advantages of home retail businesses are the speed and ease of setup, the low cost of getting started, and the ability to do the work away from your home and employer, thus minimizing potential conflicts. The disadvantages come from always working "on the road," lacking a base from which you can organize and work, having a highly variable income, and finding ways for customers to get in touch with you (although cell phones and email have made a major difference). You can arrange sales parties without selling a franchised product. One of the ways to make arrangements with minimal setup is to have the party at someone else's home. This person in return gets a portion of the proceeds in product discounts, products, or cash. You and the host work up a guest list, and the arrangements for refreshments and participation presents are agreed to in the early stages of the negotiation. Picking hosts with good contacts and a pleasant home is the key factor in party success. Often the opportunity for repeat customers and customers hosting later parties presents itself, and it's a great way to keep sales growing. Page 140 In door-to-door selling, the retailer goes to the home to demonstrate and sell the product. Matching the product to the community is a key factor. For example, it is hard to find good prospects for buyers of seeds if you are working an apartment community. Think about the

income and lifestyle of the community with respect to your product. The fundamental success factor in door-to-door selling is closing the sale. Closing means getting the customers to agree to buy. Amazingly, asking the customers to buy is often all that is needed. If the answer is no, the natural comeback is to ask customers what they need to know or have in order to buy. If they tell you something they need, your job becomes trying to meet that need. Meanwhile you continue to ask if they are ready to buy. Only if you cannot meet a need of a particular customer do you give up and go to the next customer.38 Another variation on the home model is network marketing efforts, also called multilevel marketing or MLM. These are organized through a parent organization; agents sell in part using in-home parties and person-to-person sales. The added twist is that current salespeople are invited to recruit additional new salespeople. The recruiter gets a commission from the sales made by his or her recruits. Everything mentioned previously also applies in network marketing, with the added need to carefully check into the parent organization and the terms of the recruiting. The extra caution is necessary because illegal pyramid schemes are often made to look like legal MLMs. For example, where the fees paid by newly recruited network members are paid directly to more senior network members, there is a good chance you are seeing an illegal pyramid scheme. You can check with the Federal Trade Commission (www.ftc.gov) and the Better Business Bureau (www.bbb.org).39 Stand Retail Stand retailing—the roadside, flea market, farmers' market, or craft fair business—is one of the most ancient forms of small business. It is mentioned in the Bible, and marketplaces full of stands have been found in virtually all archeological digs. Today, stands tend to be either semipermanent ones that remain in one place and are built to be sturdy, like a farmer's roadside stand, or movable ones that can be quickly assembled and disassembled for use in farmers' markets, flea markets, and craft fairs. To get started inexpensively, people often start selling from the back of their cars or using a folding table or blanket laid out with wares. • This part-time business worker has his finger on the pulse of a niche market, capitalizing on the limitations experienced by people on the streets of New York who are hungry for a snack. His signs and position on a street corner create visibility and boost market desire for his products. His stand allows him to easily move elsewhere as he perceives needs. If you were positioning in a downtown for lunch and dinner traffic, how would you decide where to move your cart? Jennifer Santolla/Alamy Stock Photo The advantage of stand businesses is that you can start with little investment. Stands can be a box or ground cloth. They also do not require a lot of investment in inventory. There are a variety of locations where a stand can be set up, such as flea markets. Stands can also be quickly established and easily ended as a business. Stands vary widely in the products they sell. The disadvantages of stands are the variable income they provide; the difficulty of making sure your stand and business meet legal requirements such as compliance with registering, licensing, and zoning (for help with this look at the

section “Exchange: Dealing with Others” later in the chapter); the problem of knowing how to price goods; and the building up of a customer base for your stand. Page 141 While stands can be among the least expensive ways to set up a shop, a high-end version exists too. It is the mall cart, if it is on wheels, or kiosk, when it is in a fixed location. Carts and kiosks cost between $2,000 and $10,000,40 although carts can be rented from many malls. Carts and kiosks are often among the most expensive locations in the mall in terms of rent per square foot. A cart in a high-end mall like the Mall of America in Bloomington, Minnesota, can go for $2,300 or 15 percent of sales a month in rent.41 Costs include rent (usually a percentage of sales with a base monthly rental), mall member fees, and cart design costs. On the other hand, carts can be rented for specific periods (holiday seasons, weekends). The advantage of carts and kiosks is that your products can be seen by more than 100,000 people a week as they walk through the mall. One idea to minimize rents is to consider placing your cart or kiosk away from the high-traffic locations, but near specific stores where your most likely customers would come from—for example, putting a trading card kiosk near a mall arcade or sporting goods store.42 The key success factor for a stand is having a location where there is enough foot or vehicle traffic to sustain the business. High traffic concentrations are why flea markets, farmers’ markets, and craft fairs are popular locales for stands. However, even these locations will have traffic levels that vary. Try to locate on or near a major walkway, or near the food, entertainment, or major vendor areas to get the most traffic. Always make sure to keep your documentation (e.g., vendor’s permits, licenses, tax numbers, etc.) handy for checks by police and venue officials. The other success factor is inventory. You might be selling products you make yourself. The next best thing is to start with what you know. If you have seen someone’s work and think it would sell, ask if you can be an agent or reseller. If you are looking for others’ products to sell, there are a host of sources (like wholesalers shopify.com and Doba.com) or you can go online to search for products or services to resell at the Industrial Resource Network, or at Thomas Register’s online site, which has a print version available in many libraries. You can also do a search online for the manufacturers of particular products.43 Pop-Up Businesses One trend that we see increasing across the United States, Europe, New Zealand, and Australia is that of pop-ups. We see pop-up retail shops, pop-up restaurants, pop-up festivals, pop-up art galleries—the list seems endless. But what are these pop-ups that seem to be so much the trend today? According to Wikipedia (every college student’s first-choice research tool): “Pop-up retail, also known as pop-up store (or pop-up shop in the UK, Australia, and Ireland), or flash retailing, is [the practice] of opening short-term sales spaces.”44 Pop-up store in London, England. singh_lens/Shutterstock Page 142 What makes a pop-up a “pop-up” is that its venue is temporary—here today, but gone tomorrow. The space where a pop-up business is selling classic vinyl records today may well be the space where Halloween costumes are being sold tomorrow. Pop-up shops and

restaurants are typically small, sometimes as small as a single shipping container. One of the most interesting things about the pop-up fad is who is getting into it. It is not just individual entrepreneurs. City governments, colleges, arts alliances, charities, and many, many more organizations are either opening their own pop-up businesses or sponsoring venues in which entrepreneurs may open pop-up businesses. Cities as diverse as Leland, Mississippi, and San Antonio, Texas, sponsor pop-up business events. Leland, for example, holds an indoor pop-up event three times a year in conjunction with established festivals such as the "Frog Fest"45 which is held annually in October to honor hometown artist Jim Henson, who created the Muppets. San Antonio's Center City Development and Operations Department (CCDO) offers no-cost short-term leases in various vacant downtown properties for pop-up businesses. The city also sponsors seasonal pop-ups along designated city streets and in neighborhoods popular with tourists.46 The American Culinary Institute sponsors pop-up restaurants at all three of its campuses in Hyde Park, New York; Greystone, California; and San Antonio, Texas. The restaurants vary in cuisine, showing off the skills that students have mastered in their courses of study.47 The Walker Art Center in Minneapolis, Minnesota, sponsored a pop-up art sale with items ranging from $2 to $12,000. The proceeds were split between the artists and the Art Center gift shop.48 Goodwill Industries opens dozens of pop-up stores each year in cities all across America. In a very real sense, the pop-up phenomenon is not new at all. In fact, it is very much like the stand retail discussed in the previous section. However, it is very much a part-time business. For part-timers the big advantage to a pop-up business is its extreme flexibility: Pop-ups do not have a fixed place of business. Pop-ups exist for only a short time—a few hours, a day, or a few weeks. Pop-ups are designed to be easy to set up and take down. Pop-ups can easily be set up in new locations. Pop-ups must be special, distinct from other permanent businesses. Mobile Offices One recent survey suggested that one in six working Americans works from their cars or trucks. The kinds of jobs that involve face-to-face selling and client services are the ones most likely to be done from a car or truck. There are advantages to this approach. There is no rent, and car expenses can be deducted from tax returns. It places the entrepreneur close to the customer, and typically close to the entrepreneur's printed materials or tools. The key to a mobile office is a cell phone and a laptop with Internet access and a printer (especially one that can be run from a USB port on the laptop). To keep everything powered, getting a power converter with a lighter plug will usually do the trick. What many mobile teleworkers initially forget is how important it is to have a comfortable place to write and mark up written reports—working behind the wheel gets old fast. Berny Coffee was an early entrepreneurial leader in teleworking. A yacht broker in Alexandria Bay, New York, Berny manages a network of 35 brokers from his car. The key for getting his work done is his cell phone, and a Wave Board wireless router, which connects him to Verizon's EvDO wireless network from wherever he is located. He

runs it through a power converter plugged into his cigarette lighter. With the router working, he can even ditch his cell phone and call around the world for free using Skype. With this approach, Berny was even able to stay in business from Florida during a hurricane when people had no electricity and few cell phones worked.49 These days, if you have a 3G or 4G cell phone or one of the 3G/4G wireless modems for your laptop, you should be able to mimic Berny's feat. • Today cell phones and laptops with wireless modems make it possible to run your business from your car. For a one-person, part-time business that wants to get close to customers, there is no better arrangement. What kind of features would you want in a car if you were going to use it as your primary office? Comstock/Stockbyte/Getty Images Page 143 In terms of the car or truck, make sure it can accommodate you, all your equipment and files, and your telework equipment (and can handle the drain on the car's battery over the long term). It is also important that it provide adequate and comfortable accommodations for passengers. You may not drive them often, but you are likely to have them in the car for business discussions. Virtual Offices, Executive Offices, and Incubators When stresses in the home are making the home office problematic, but your business is not ready for a full-time rental, one approach is to look at outsourcing your office. A virtual office is actually the next step to most business web hosting packages. In addition to handling your emails and newsletters, a virtual office typically gives you access to your files, as well as web-based fax services and, most typically, full business telephone services including phone trees, voice-mail services, and often additional phone-based services such as reminders, and call forwarding based on the time of day. Major players include Regus.com, Onebox.com, and Hq.com.50 Executive offices provide small amounts of short-term space for an office or work area. They can be furnished or unfurnished, and provide basic utilities. They often have preferred vendor arrangements for phone services (which may not always be the best deal—keep using your cell phone) and low-cost shared services such as copying and telephone answering by a live receptionist. Regus and HQ also offer such services, as do InstantOffices.com and IntelligentOffice.com. A variant of these are called coworking spaces, which generally include a large open office space where you pay a daily, weekly, or monthly fee for access, and usually include all the Wi-Fi and coffee you can use, along with printers and copiers you can buy time on and bookable spaces for meetings. Google "coworking space directory" to start your search for one near you. Another solution you might find interesting is to see if you can rent space in an incubator. Incubators are community-based organizations designed to help small businesses. For-profit incubators are very similar to executive office operations, although usually with somewhat lower prices. Nonprofit incubators are often sponsored by universities, economic development agencies, or localities themselves. They tend to offer heavily subsidized space, shared services like executive offices, and almost always offer on-site expert advice about running small

businesses. The key online directory for incubators is run by the National Business Incubator Association at nbia.org. Doing Business without a Business Organization: using Consignments and Agents Artists, artisans, authors, inventors, small-scale manufacturers, and collectors of antiques or other collectibles all have one thing in common: They possess something they would benefit from selling. Often, these people start small part-time businesses to do that. With the advent of general selling platforms like eBay.com and specialty platforms like etsy.com, selling your work has never been easier. For inventors or makers, as they are known today, crowdsourcing platforms like quirky.com for idea generation and refinement or kickstarter.com or indiegogo.com for funding make it easier than ever to get your product together, both figuratively and literally. However, many others prefer to stick to their creating or discovering and let someone else handle the selling process. The kind of businesses that do this are called a variety of names such as consignment shops, auctioneers, or sales agents. Regardless of the name, the basic business model remains the same. The agent (we will use this term for the person running the consignment businesses) will take on the product of the creating or discovering or manufacturing part-time entrepreneur. Some agents charge a basic fee up front to cover initial expenses; some do not. All agents make an effort to sell the product they were given. When sold, the agent gets a portion of the sale price, with the remainder going to the part-time entrepreneur who employed the agent. Let's look at two different types of consignment situations—eBay consignment shops and intellectual property agents. An eBay consignment shop starts with you dropping off your item. The consignment shop photographs the item, prepares a description, and posts it on eBay. When the item is sold, the shop ships it to the buyer and sends you your share of the sale price. There are several national franchise chains offering drop-off consignment services such as 877isoldit.com or sellforme.ebay.com. There are also hundreds of small, independent local consignment stores. An excellent listing of eBay drop-off stores can be found at drop-off-stores.com/. Although there is wide variation in pricing, the eBay consignment stores generally charge a percentage (around 40 percent for the smallest items, with less for larger sales) for their work. Page 144 Intellectual property (IP) refers to original works like inventions, visual and performing art works, books, and computer programs. We will learn about the many ways to legally protect IP in Chapter 17, but for now just think about how you might get money for some IP you have created. There are a variety of agents who specialize in different types of IP. Experts (often lawyers by training) called IP agents usually focus on placing inventions, computer programs, and manufactured products with companies willing to pay to add to their complement of new products. Sometimes companies will buy competing IP to prevent their competitors from getting it. For works of art, there are a variety of specialized art agents. You have probably heard of book agents (also called literary or publishing agents), and there are similar types of agents for designs and paintings. Aaron McGruder

created a comic strip called The Boondocks. Once he learned how hard it was to place a cartoon strip with newspapers and get a good deal doing so, he found the best artist agent he could to find the most motivated seller possible to help him structure a deal that got him the money, ownership, and editorial control he wanted. Regardless of the type, you can find listings of agents through a Google search using the terms given previously. Finding the right agent for you requires some additional research. While an agent close to where you live means you would be able to meet face-to-face, local agents may lack the contacts in the major corporate, manufacturing, media, or artistic centers where your work could get its best offer. Some suggestions for how to find a good agent include: Check out the agent's biography and track record, as well as searching for articles confirming his or her accomplishments. Often there are a couple of local lawyers in the nearest big city who have experience dealing with agents from the major cities. It may be possible to get referrals from them. Don't be afraid to write someone in your field whom you respect and ask for his or her recommendation. The individual knows a bit about the business and may be able to give you some direction. Often faculty in your college or university may have experience with, or connections to, agents. Look for faculty who have done any mass media work (best-selling books, national TV, movies or radio, nationally sold designs or works of art, and faculty with patents, etc.). In all forms of consignment relationships there are a few things you should always consider. For any consignment, make sure there is a written contract outlining what the consignment agent will do to sell your product, what the costs and fees are, and how they get paid (some will come out of the selling price, whereas others may be paid up front). It is also crucial to have a clear description of the product and any variations, parts, pieces, and manuals included. For physical products and works of art, the description should mention the condition of the items and any blemishes—photos help.51 The advantage of consignment approaches is that they permit full-time sales with only a part-time involvement from you, low setup cost, a low risk level, and the flexibility that comes from the variety of consignment agents and agencies available to you. The disadvantages can include little effort being put forth to sell your product, high potential for competing offerings, long amount of time before payouts, and lower profitability because of agent's fees.

Key Considerations for Success in Part-Time Entrepreneurship 5-4 Describe the key factors to making a decision to go into part-time entrepreneurship. When you decide to pursue part-time entrepreneurship, there are usually two major questions: What kind of product or service do you want to offer, and how do you want to organize your part-time business?

Chapter 4 discussed the process for coming up with a good (and maybe even a creative) idea for your business. In this chapter we will focus more on how you would get that business started part time. Page 145 For the second question, about how to organize your business, there are usually three key considerations for part-time small business start-ups: The cost to start up your new part-time business. The time to start up your business. The permanence of the business you are creating. For part-time businesses, you want a low cost of start-up, since you probably will not have a lot of money to invest, and may not get great returns to pay off expensive start-up efforts. Time to start up is also best when shortest, since you are looking for a basic idea of what might and might not work. The more time and energy you spend preparing for a small-scale part-time business, the longer it takes to make a profit. The good news is that in most cases, the cost to start up and the time to market are closely related. Permanence is related to the concept of legitimacy discussed in Chapter 3. For a small-scale, part-time firm, it may be hard to have a lot of the indicators of legitimacy. What customers want to know is that the firm is likely to be around for a while, to provide customer service and future sales. That is the fundamental idea of permanence. The three considerations are at the heart of most people's decisions about their mode of entry to part-time entrepreneurship.

Success Factors for Part-Time Businesses 5-5 Use the BRIE model to describe what it takes to be successful in part-time entrepreneurship. Research indicates that most service and retail firms typically start out as a hobby.52 There are many different ways to start a part-time business. Consider, for example, the way Courtney Hennessey Hopson got Codi Jewelry going (see the Small Business Insight). The BRIE model introduced in Chapter 1 points out many of the key factors you need to think about. Intention is usually where part-time businesses start in the BRIE process, and we talked about key resources—such as inventory or competencies—earlier. Let's go further to address the two other aspects of the model for part-time businesses: boundary and exchange. SMALL BUSINESS INSIGHT Courtney Hennessey Hopson and Codi Jewelry54 Courtney Hennessey Hopson of CodiJewelry.com did not intend to go into the jewelry business. It just grew. During Christmas break of her junior year at Saint Louis University, Courtney decided to make stretchy crystal bracelets for her friends as holiday presents. When she left the bead store, she had another problem—she had spent $400 on beads and string, and she needed to make the money back before her father found out. Courtney became a walking ad for her bracelets and sold them throughout the holiday, including at a family wake. Eventually the business grew to have in-person and online retail sales as well as wholesaling to stores, including Neiman Marcus. Eventually Courtney won a Global Student Entrepreneur Award for innovative thinking. • Courtney Hennessey Hopson, the founder of Codi Jewelry, began

her small business part time out of the necessity to recover her Christmas gift-making costs. Like many others highlighted in this chapter, her part-time business afforded her the chance to earn a reasonable profit while carrying on with her other life priorities. Courtney Hennessey Hopson Boundary: Separating and Balancing Business and Home Time is central to balancing home and business. It is important to organize a business around a schedule that makes sense for you. Internet-based businesses let you work anytime that is convenient for you. For Courtney, having time during Christmas break was critical. Operating on weekends at roadside stands or at flea markets or farmers' markets is the best way to structure time that is convenient for you and your customers. Either way, time management, as discussed in Chapter 2, is the crucial skill for juggling your part-time business and the rest of your life. The key device for managing time is the to-do list. To be effective, the list needs to be with you at all times. You can get by with a small notepad, or can go for preprinted organizers, such as those from Day-Timer or Franklin Covey. Your smartphone almost certainly has a calendar that usually includes a way to post reminders or to-do lists. There are also free apps like Toodledo, Google Tasks, Remember The Milk, and others, often with smartphone and web versions so your list can always be a click away. When using a to-do list, be sure to list the key information such as due dates and contact information if it applies. Most entrepreneurs find that it also helps to prioritize the list. One of the simplest ways to do this is 1-2-3 ordering. Those activities that are absolutely essential to your business or life are coded 1. Those that are current but of lesser importance or that can be rescheduled if necessary are assigned a 2. Activities that you want to do when you have some extra time or that have due dates far in the future get coded as 3. Typically, owners keep a to-do list of 6 to 20 items per week, and they reprioritize on a daily basis.53 For people with a part-time business, the to-do list includes items from business and personal life. For students, tests are probably a 1 priority. For parents, children's extracurricular activities are also 1s. Often family and personal lives make demands that put business and the rest of life in conflict. Page 146 Having some general rules to help sort out these conflicting demands helps. Fred Kiesner, an entrepreneurship professor at Loyola Marymount College, suggests six key ideas:55 Do not waste time complaining; do something about a problem. Do not aim for perfection; "good enough" really is good enough. Do not dwell on the past; just plan to do better next time. Minimize your time spent in meetings, or schedule meetings to be short. Schedule and protect quality time with your family. Schedule and protect some time for yourself to have fun. The majority of part-time businesses are based in the home. The business takes space, uses resources the family also uses, and generally places stress on the household. Keeping a clean boundary, like an area known as the "business corner," helps make sure that family and business are protected from each other. Exchange: Dealing with Others Page 147 There are two key groups outside your business with whom you must deal—

government and customers. Even part-time businesses have to deal with government, and three issues pop up repeatedly: registration or licensing, taxes, and zoning which was discussed earlier in this chapter. For businesses run from a home or commercial venue like a fair or consignment shop, most states and localities require some form of registration, but the requirements vary so it is important to check. The U.S. government has a web page with links to state registration information at www.sba.gov/starting-business/choose-register-your-business. On the site, click on the menu item "Register your business." Note you might need to register your business name and possibly register your business with particular state agencies depending on your industry or occupation.56 This is often called licensing. For example, home-based hairstylists need state licensing, and in many states home-based day-care providers need to get special registration and, in some cases, licensing. Even when you do not have to register a business, you need to keep track of your sales in order to pay your income taxes later. Although taxes are discussed in Chapter 13, it is useful to mention here that you want to keep track of your costs, too, because if you itemize your deductions on Schedule C, you can deduct your costs from your income (and a lower income means lower taxes). In many states and localities you must also pay sales taxes, and these often need to be kept in a separate bank account and tracked as well. Often, flea markets and craft fairs include temporary local tax numbers in the booth rentals, but it is important to check. Pricing and Costing Because exchange is the way businesses make profits, it is important to price your goods or services to make profits likely. Folks working part time can be prone to underestimate their costs. Using things found around the house or neighborhood or not adequately considering the cost of the time you contribute are typically what lead to underestimating the cost of a product or service. Taking some time to think through the real cost of your product or service is critical to your success. Central to figuring the real cost is recognizing that your own time has value. When you price your product or service to pay yourself what you could get working part time for someone else, then you have achieved a real milestone on the road to growing your business. Pricing is also often seen as a challenge by part-time businesses. Even if the business is part time, that does not mean the prices have to be cut-rate. One good way to get an idea of realistic pricing is to price competitors' offerings. Doing some window-shopping in person, via catalog, or on the Internet is the classic way. Once you know the kind of price your product or service can get and once you know your costs, then you are in a great position to know the kind of profit it's possible to make in your business.

What Are the Challenges of Being an Entrepreneur Part Time? 5-6 Describe the advantages and pitfalls of delegating and outsourcing. Four aspects of part-time entrepreneurship are very different from full-time business. Gaining legitimacy and trust among customers is

discussed in Chapter 3. Three other key aspects remain: determining what you are able to delegate, the special ethical challenge that comes from juggling part-time entrepreneurship and other work, and the challenge you face when you try to move from part-time to full-time entrepreneurship. Delegation and Outsourcing For part-time entrepreneurs, time is the ultimate resource. While the most successful entrepreneurs in high-growth ventures are those who learn to get and leverage other people's money (OPM), for entrepreneurs in part-time businesses the key is leveraging other people's time (OPT). There are two major ways to do this—delegation and outsourcing. Delegation happens when you assign work to those over whom you have power, usually people you employ, those volunteering to help you out, or family members. When you employ outsiders who are not your employees to handle all or part of a functional area of your business, it is known as outsourcing. Delegation makes sense in two situations. The first is when others can do things better than you. For example, an entrepreneur who is a wizard at sales may be totally lost doing the books. The second is when you want your business to operate when you are not present, or operate in two places at once. If you have two people working in a store, you could be selling to two customers at once. Done well, delegation frees the owner to pursue those things that make the biggest difference in the business—key sales, strategic thinking, negotiating, or inventing. It is a powerful concept, and there are several tips that can help make any delegation effort more successful.57 Page 148 Start delegation with simple tasks to get you and your employees used to the process. Match the task to the person with the best skills and attitude for it. Solicit questions from your employees about the delegated work. Attach a motivating outcome to the delegated work—a chance to learn new skills or demonstrate leadership, increased visibility, or an opportunity to see more of the business or its customers. Allow time for the employees to learn the task and correct the inevitable early mistakes. Give employees feedback about their performance soon after they start. Hope for perfection in performance, but be satisfied with good enough. Once delegated, do not take back responsibilities. When problems arise, remedy them, rethink your approach, and retrain the employee. Delegation is not for everyone and every situation. It makes the most sense when you have people who are good at their jobs and trustworthy, but with some additional steps, delegation can work in less than optimal situations. Even with these tips, being able to delegate depends on the owner's ability to trust others and on the quality of the people to whom the owner can delegate. When delegation is essential but it is hard to trust employees, checking up on an unpredictable schedule helps keep the employees on their toes and provides maximum assurance to the owner. When trust is high but employees lack skills, the owner should allow time to train them and monitor their work—frequently at first, but less often as they prove they know their jobs. As noted earlier, when you employ outsiders who are not your employees to handle all or part of a functional area of your business, it is known as

outsourcing. The most popular types of outsourcing among small businesses are shown in Figure 5.6. FIGURE 5.6Functions That Small Businesses Often Outsource Page 149 In the nineteenth and twentieth centuries, the idea behind automation was to save time. If you can get a computer program or another company to do work instead of you, you save time and that is good. Figure 5.6 shows that the most technical aspects of a business—issues such as law, computers, or financial records—are the areas in which outsourcing is most likely to occur. This provides some insight into how to think about outsourcing. In areas in which expertise is hard to come by, changes frequently, or is an important support to the functioning of the firm, it makes sense to outsource. The other key idea for outsourcing is to never outsource what defines your distinctive competence, what you think makes your business unique. Consider the example of Gourmet Gatherings in the Small Business Insight. Gourmet Gatherings's "symphony of specialists" suggests the kind of careful involvement and oversight needed to make outsourcing work. Activities that are central to the strategy of the business, like cooking and running the cooking groups for Gourmet Gatherings, stay inside the firm. Activities that are not strategically critical are outsourced, especially when they can be done better or more cheaply by outside firms. SMALL BUSINESS INSIGHT Gourmet Gatherings58 Bibby Gignilliat has bounced from job to job. She was a programmer, bookseller, travel agent, bike tour guide leader, public relations representative, and marketing manager before she started as a cook teaching for HomeChef and later on San Francisco television. Her prior skills equipped her for a special project, using cooking as part of a team-building exercise for a group of lawyers, and later for a group of 40 businesspeople. This led to the idea for Gourmet Gatherings, which provides culinary entertainment "designed to inspire conviviality, camaraderie and confidence in people who appreciate good food." Armed with a strong network of contacts, Bibby partnered with longtime friend Shannan Bishop (their fathers were partners in a brokerage business). Bibby's varied experience had an interesting side effect—she knew all the kinds of work she did not want to do. So she and Shannan outsourced every function of the business except the recipes and menus and leading the gatherings. Their financial, marketing, legal, and web work were all outsourced. They describe their role as "conducting a symphony of specialists" and argue that they could never have grown if they had to do everything themselves. Besides, it was the cooking that was fun, not the bookkeeping. Ethics and Part-Time Small Business 5-7 Identify the ethical challenges of part-time entrepreneurship. It is impossible to gain legitimacy for your small business if your ethics are in question. There are two situations in which part-time entrepreneurs are particularly at risk: moonlighting and aggrandizing. Moonlighting Often, the most successful small businesses build from the business expertise and personal contacts of the entrepreneur. However, managing this without offending your current employer, or getting into legal or contractual trouble, is not easy. Working on your own part time after

your regular job is called moonlighting, and it poses particular risks. The major concerns are conflict of interest, cannibalizing sales, and poisoning the well. Conflict of interest crops up when people do work for their part-time business while they are at their full-time job, blurring the boundary between them. Conflicts of interest happen when what is best for your part-time business is different from what is best for your full-time employer or when people cannot be sure which of the two firms you represent. The key is to keep your full-time and part-time jobs clearly separate. For example, do not contact customers of your part-time business when you are at your full-time job. Page 150 Cannibalizing means taking business away from your employer. This can come from your taking sales away from your employer or taking working hours away to do your own business. This is a real problem if your part-time business is similar to your full-time occupation; for example, if you are a painter for a building contractor in your day job and do similar sorts of painting as your part-time moonlighting enterprise. In such cases, the usual course is to get your employer's approval at the start. This, however, may be easiest to get when the kinds of work you are doing, or the kind of clients you have, are not like those at your day job. In fact, it is often possible to get your boss to refer customers to you when they fit your type of schedule, pricing, or type of work a little better than that of the bigger enterprise. Poisoning the well refers to creating a negative impression among your employers' customers. If you use your business contacts through your day job as the basis for your part-time self-employment, you will inevitably find some customers who do not want to hear your sales pitch. If, because of this, they tell your employer they are less likely to buy from him or her, your part-time business has hurt the full-time one. The traditional work-around for this is to develop a separate customer list without names from your full-time job and then wait for your employers' customers to ask you about this other business they hear you've started. Aggrandizing For a part-time small business, achieving legitimacy and business respect can become a driving force. Occasionally, the entrepreneur sees an opportunity that is possible, but a stretch. If it looks like a stretch to the customers, the entrepreneur may start thinking about making the firm seem bigger, more substantial, or more capable than it really is. This misleading impression, called aggrandizing, can spell the death of a firm if discovered at an inconvenient time. As discussed in the following Small Business Insight, this was the lesson Jeremy Barbera encountered in the early days of his business. Jeremy "got away with it." He lied quickly and easily, no one checked up on his firm, and he was able to meet his obligations. However, if his aggrandizing had been exposed before he could prove himself, he would have lost all credibility. Jeremy says that an entrepreneur has to take risks to get ahead. When he started his firm, checking up on a firm required time-consuming investigations or credit reports, so Jeremy's risk was perhaps not so great. Today, with credit reports and business directories available online in seconds, the potential for being found out is much higher, and the risk is greater. The most typical form

of aggrandizement is implying that a firm is full time when it is only part time. Recall from Chapter 3 that it is hard for a part-time firm to achieve the legitimacy of a full-time firm, and there can be a strong temptation to make the firm sound like it is a regular nine-to-five business. Remember that in the end, however, the biggest risk is that of losing the trust of your current and potential customers. In a small business, especially a part-time one, the owner is the business. If you cannot trust the owner, you cannot trust the firm. Moving from Part-Time to Full-Time Entrepreneurship 5-8 Describe the challenges of moving from part-time to full-time entrepreneurship. Some people start their businesses part time with hopes of moving to full-time operations when the time is right. For them, landing a major contract or sale may be the financial and marketing indicator of the right time. Others start part time and want to stay that way, and they can face challenges when they achieve success. The strains of producing goods or services for a voracious market can make staying part time difficult. In deciding whether to make the move to full time, the key question is usually financial. If you are already employed full time somewhere else, the move to full-time entrepreneurship means taking a close look at your financial situation. Can you afford to go on your own? This means having enough to cover personal and family expenses (typically for six months), as well as business expenses (see the following Small Business Insight). There may also be new costs, as you scramble to replace employer-provided health insurance. SMALL BUSINESS INSIGHT Metro Services Group Inc.59 Trained as a physicist and employed by the National Aeronautics and Space Administration (NASA), Jeremy Barbera started Metro Services Group Inc. as a part-time business at his kitchen table with his "partner," his mutt Luka. Of the $900 he invested in the business, $200 went to rent a Madison Avenue mailing address at a local incubator to help his business look more professional. Selling direct marketing services to financial and entertainment firms, Jeremy was a one-person operation, but he consistently stretched the truth. For example, he used "we" and "us" when talking about the firm. He would promise a prospective client to have his secretary type up the proposal and courier it over before 5 p.m., but it was Jeremy who did both. This once came close to backfiring. Jeremy had delivered the proposal in the afternoon, dressed as a delivery person, and reappeared the next morning for the follow-up meeting with the CEO, this time attired in suit and tie. An alert security guard informed the CEO's office that the delivery man claims to have a meeting with the CEO. Jeremy told the guard and CEO that the delivery man was his brother, down on his luck. Jeremy's favorite line was, "It all depends on the light you portray yourselves in." Jeremy made MSGI look bigger than it was until it landed its first contract—with American Express. Page 151 The way to determine the financial situation of a business is through crafting a business plan such as the one you will learn about in Chapter 8. Having a business plan helps you work out all the major details of the business and how you plan to organize it as you are growing it. For example, Nancy Bombace of Mill Valley,

California, took the time to do a business plan before taking her part-time honeymoon registry service, HoneyLuna, full time. By doing the plan, she learned she needed to keep her full-time job and run HoneyLuna on the side to make ends meet.60 In addition, bankers, lawyers, big corporate customers, consultants, and potential investors will ask you for your business plan, so it makes sense to do one to show you have done your homework in starting a full-time business. There are several ideas to keep in mind to help in this transition. First, it often makes sense to wait until there is a solid income likely for the business before moving over to full time. Second, make use of any transition services your former employer offers, such as COBRA health coverage (look at www.dol.gov/dol/topic/health-plans/cobra.htm to get information on this from the U.S. government). Third, recognize that initially at least you will spend nearly all your time running and marketing the business, so it makes sense to change over when your family and personal obligations are at their lowest and support from family and friends is at its highest. Often people move into full-time entrepreneurship by building their part-time work to longer hours, until they have, in effect, two full-time jobs. Done this way, sleep, family, and personal time take a hit, but as a financially secure way to operate, the two jobs approach is great when done for short periods.61 Like the work of Nancy Bombace, Jeremy Barbera, or Courtney Hennessey Hopson, part-time entrepreneurship is around you all the time. Millions of people are working at part-time businesses of their own. Whether in retail or wholesale, selling services or products, they or their wares are in our stores and our markets, on our streets, and in our homes. Part-time entrepreneurship is important because it gives people a chance to learn the ropes in business and to test out their ideas. It also is often the only way people can engage in entrepreneurship amid their other responsibilities. Part-time entrepreneurship is important as a test bed for starting full-time, larger firms and as a means of self-reliance and self-expression. However, as long as a few minutes online or simply saying “I can do that for you” to a neighbor is all it takes to start a part-time business, it will remain an option that lots of potential entrepreneurs are certain not to overlook.

CHAPTER SUMMARY 5-1 Describe when and why part-time businesses are important. Part-time businesses are important because the majority of new business start as part-time businesses. They are important because almost half of operating businesses are part time enterprises. 5-2 Describe the conditions that make part-time entrepreneurship a good decision. It is a good decision when you need to gain basic experience. It is a good decision when you lack the resources for a full-time business. It is a good decision when you face a narrow window of opportunity. It is a good decision when you are concerned about the demands of going into full-time business. 5-3 Describe the kinds of part-time

entrepreneurship that exist. Businesses may be operated part time in any industry from accounting to zookeeping. Many part-time businesses are conducted from the entrepreneur's home. Most home retail businesses, such as home parties or network selling are operated on a part-time basis. Many other part-time businesses work from mobile offices, virtual offices, executive offices, and business incubators. Websites providing information or entertainment may be part-time businesses. E-commerce, including eBay and Amazon sellers, is often a part-time business. Pop-up businesses are usually part time. Services such as sales agents may be done on a part-time basis. Stand-based businesses, such as roadside stands, flea markets, farmers' markets, and fairs, are normally operated part time. 5-4 Describe the key factors to making a decision to go into part-time entrepreneurship. You should consider the cost that will be required to start a part-time business. You should consider the amount of your time needed to start up your part-time business. You should consider the permanence of the business you are creating. 5-5 Use the BRIE model to describe what it takes to be successful in part-time entrepreneurship. Use the BRIE model to help identify key boundary and exchange issues. Boundary—you need to manage your time carefully and keep business and home separate. Exchange—you will need to register with the government, pay your taxes, and comply with zoning regulations. You will also need to keep careful track of your costs including the cost of your own time. 5-6 Describe the advantages and pitfalls of delegating and outsourcing. Delegation is getting others to do your work. It can help an entrepreneur get more done. Managing the delegated work and the people performing it is a key challenge for the entrepreneur. Outsourcing is paying experts to take on the functional tasks of your business. You may outsource to experts anything but the tasks that make your firm unique. 5-7 Identify the ethical challenges of part-time entrepreneurship. The two ethical challenges of part-time businesses are moonlighting and aggrandizing. Moonlighting can result in cannibalizing sales from your employer or poisoning the well by making your employer's customers angry. Aggrandizing can happen when a part-time firm tries to present itself as a full-time one or a bigger one than it really is. 5-8 Describe the challenges of moving from part-time to full-time entrepreneurship. The key challenges of moving to full-time self-employment are mainly financial. Do a business plan to assess your financial situation in the new business. When you make the move, do it when support from your family and previous employer are at their strongest. Consider increasing part-time work hours until you are working two full-time jobs, and then quit to devote your time to your full-time business.

KEY TERMS part-time employment full-time employment pop-up business episodic business hybrid entrepreneurship part-time business volatility zoning laws covenant

variance e-commerce informational website business-to-consumer (B2C) business-to-business (B2B) consumer blog RSS feed tweet multichannel marketing reciprocal link search engine optimization (SEO) sponsored link reverse auction reserve price home party door-to-door selling network marketing venue incubator maker intellectual property (IP) cost to start up time to start up permanence registration licensing delegation outsourcing moonlighting conflict of interest cannibalizing poisoning the well aggrandizing

DISCUSSION QUESTIONS What are the three situations in which it might make more sense to go into business part time rather than full time? If you were going to start a home-based consulting business in a dorm room, what do you think would be the greatest challenge to face? What about if you were starting the same business from home? The two major types of business websites are informational and e-commerce. What are the differences between them? Is it possible to sell products on eBay without having an online store? What would be the advantages and disadvantages of doing so? How would you use multichannel marketing to promote your part-time businesses? If you had to use one of the non-free approaches, which would you choose and why? What are the differences between home party and door-to-door retailing? When managing your time using a to-do list, how do you go about prioritizing the list? Why? What kinds of tasks do small businesses most often outsource? Why do you think they are popular tasks to give to others? Of the two ethical problems prevalent to part-time small businesses (moonlighting and aggrandizing), which do you think is the biggest problem for entrepreneurs? Why?

XPERIENTIAL EXERCISES Search for art fairs in your area using Google Maps. In the search box type “art fair” (leave off the quotes when you type) and the city and state you are checking on. When you look at the results, try the links for category searches to see if you get a narrower set. Check the kind of licensing you need for a part-time business in your state. Go to www.sba.gov/starting-business/business-licenses-permits. Note that there are several different types of permits, licenses, and certifications needed from nearly every level of government. So start by looking at “Federal licenses and permits.” See what requirements (if any), your type of firm has. Then click on “State licenses and permits” and select your state. The SBA site has links to the state office in charge of business licensing. Research pricing your product or service electronically. Go to eBay.com (if you are selling a

product) or Upwork.com (if you are selling a service) and enter the term for your product or service. From the resulting list, note the offerings that most closely match yours and check the prices posted. If possible, look for recent sales or contracts for your offering to see what people paid for the goods or services. Create your own first-pass customer base. List family members; friends; people you know from religious, fraternal, civic, and school organizations; and people who provide you goods and services. Look at the list again and select five people who you think are most likely to know the kind of person you would imagine would make your best customer. Create a to-do list for the upcoming week using the technique described in the chapter. Prioritize your tasks using the 1-2-3 method, and use the list for a week. Ask yourself if you felt having the list helped you remember better what you had to do and if it helped you better decide what to do and when to do it. Do a Google search for "pop-up business guides." See if you can find a guide for your city or state. If not, what kind of help do you find?

MINI-CASE TIM HAYDEN'S LAST VACATION In the four years since missing St. Louis Cardinal Mark McGwire's 70th home run in St. Louis's Busch Stadium in 1998, Tim Hayden had been toying with the idea of creating some sort of electronic device to let people attending a sports event enjoy the same sort of video and informational graphics that people who watch the game at home enjoyed. He even figured out the technology needed. He would use a PDA with Wi-Fi capabilities, "hardened" through its construction and tough case to be able to withstand liquids and the kind of rough handling you would expect among spectators at a sporting event. He would call it SkyBOX. In his spare time, he pursued the SkyBOX idea with sports managers, advertisers, computer people, and with everyone he met. A tech-savvy marketing manager by trade, Tim knew what the user interface would look like. Having no budget for his part-time business, he had to talk friends into putting together a flash graphic of what his service would look like. He had also thought about how he could make money with SkyBOX, and how he could get the major sports leagues to support the product. Meanwhile, he continued his day job as the director of marketing and sales for a local advertising firm. He knew to make SkyBOX work he would need to leave his employer, but he wasn't sure how to decide. He was making good money and liked his work, but he was also likely to get moved from straight salary to more of a commission basis to help grow the business. He had a girlfriend. A lifelong St. Louisan, he had an active social life with his friends. He was close to his family, and they lived nearby. Page 155 The moment of truth came during a vacation Tim and his parents took in the summer of 2002 to visit family in Florida. Trading introductions around a pool, the man to

Tim's right turned out to be the entrepreneur who founded the multimillion-dollar Val-Pak mailer business, Terry Loebel. Hearing about SkyBOX from Tim, Terry was relentless: "What's your business model?" "What's in it for the league and teams?" "Are you the right person to carry this off?" Under the hot sun, beers in hand, Tim and Terry went back and forth. In the end, Terry gave Tim a look that said, "You done good kid." A little while later, Terry left. For the rest of the afternoon, Tim kept thinking, "I did it. I really did it!" He held his own and showed off his business well enough to impress a very successful entrepreneur. He knew his business, and he knew his stuff. Maybe he was ready to go for it full time. Over dinner, he mentioned his experience to his parents—a corporate entrepreneur and a self-employed HR consultant. Suddenly a raft of questions hit him he wasn't prepared for, questions like "What will you live on?" and "What about your girlfriend?" With a lot more difficulty than that afternoon, Tim started answering questions. As he got more into it, he felt maybe he was on top of the personal dimension of the prospect of going full time. CASE DISCUSSION QUESTIONS People talk about entrepreneurs depending on luck. Tim saw Terry Loebel only that one time. Their conversation was one of the factors leading Tim to decide to go full time, starting his business as "Vivid Sky" with the initial product, "SkyBOX." Was it luck on Tim's part? Was there anything Tim was doing to improve his luck? Tim had concentrated on mastering the business and technology angles of the SkyBOX, but was slightly taken aback when asked about how his personal life would change if he went into entrepreneurship full time. If you were contemplating a full-time entrepreneurial career, what are some of the personal considerations you think might be important? Why would Tim's employer's plan to change business directions make becoming a full-time entrepreneur more attractive? Tim felt he needed to go full time to take the SkyBOX "to the next level." Can you think of ways he could have continued building up the SkyBOX while sticking with a part-time approach? What would have been the downfalls?

CHAPTER 6 Small Business Entry: Paths to Entrepreneurship Page 157 LEARNING OBJECTIVES After you complete this chapter, you will be able to: LO 6-1 Describe the strategies for going into an entrepreneurial business on a full-time basis. LO 6-2 Describe five ways that people get into small business ownership. LO 6-3 Compare the rewards with the pitfalls of starting a new business. LO 6-4 Compare the advantages and disadvantages of purchasing a business franchise LO 6-5 Compare the advantages and disadvantages of purchasing an existing business. LO 6-6 Explain four methods for purchasing an existing business. LO 6-7 Explain the issues of inheriting a family-owned business. LO 6-8 Describe how hired managers become owners of small businesses. LO 6-9 Identify the choices for

exiting a business. Focus on Small Business: Paul Hedrick, How I Got into This Business Paul Hedrick, born and reared in Texas, used his Harvard economics degree and skills learned at McKinsey & Co. and L Catterton Partners to create a new model business for providing high-quality cowboy boots at moderate prices. Paul Hedrick's Tecovas offers a selection of cowboy boot styles for men and women. Hero Images/Getty Images After graduating from Harvard, Paul Hedrick took the conventional route for economics majors and accepted a job on Wall Street. After a while, he moved back to Texas where he was a management consultant. This led him to work for a private equity firm which took him back to New York. He was still dissatisfied, however, and soon was considering ways that he could go into business for himself. The defining moment was the result of treating himself to a pair of high-quality cowboy boots. He was shocked at the price. They were the most expensive single item of clothing that he owned. He realized that there was a competitive opportunity to offer high-quality boots at a much lower price. With this realization Paul quit the job in New York and moved to Austin, Texas, and began planning for his new venture. After several months of investigating the possibilities for direct-to-consumer selling of boots through vending at fairs, expos, trunk shows, and, of course, online he decided to take the plunge. His extensive research had disclosed that the leather and bootmaking capital is Léon, Mexico. He made an arrangement with an artisanal bootmaker and Tecovas, Inc. was in business. For the next four years, Paul ran Tecovas as a one-person shop. Most of his sales were made online, but he also worked filling his car with boxes of boots and selling direct to customers at various events and weekend markets. At first he provided all capital for his start-up from his personal savings. But, as his business grew, more capital than he could provide became necessary to allow the business to succeed. In the fall of 2017, Paul received an investment of $2.6 million from an angel investor in order to expand his operations and to hire the necessary employees. Today, Paul has expanded his product line to include men's jeans, leather luggage, and accessory items. All sales are direct-to-customer and made online. DISCUSSION QUESTIONS How did Paul Hedrick discover his entrepreneurial opportunity? Would Tecovas have become successful more quickly if Paul had used angel and venture capital earlier? Page 158 Why does it make sense for a seller of high-quality boots to use online selling, exclusively? What advice would you give to Paul Hedrick?

Planning a Path into Business 6-1 Describe the strategies for going into an entrepreneurial business on a full-time basis. Let's start with the assumption that you have decided to go into business for yourself. OK, how will you accomplish this? What business do you want to enter? If you are a licensed electrician, becoming an independent subcontractor makes sense. If you are an accomplished cook and love preparing for and serving people, perhaps

you might want to be in the restaurant business. If you are an experienced coder, it may be that creating a new app is your opportunity. Whichever set of talent, skills, and expertise you have, the path forward seems pretty clear: (1) choose your industry, (2) create a product or service, (3) test its feasibility, (4) determine the market, and (5) forecast sales and costs and from these specify the resources that you will need to turn your dream into reality. As we described in Chapter 4, this form of planning is called causal or predictive reasoning. Causal reasoning has been the strategy for starting innumerable businesses and it is the method taught in almost every entrepreneurship class around the world. Causal reasoning is used to create a business plan. It is the type of reasoning that is used by business managers daily for making many business decisions, including such decisions as whether to buy or to make a product, enter or leave a particular market, and hire full-time or temporary employees. One great advantage of this type of reasoning is that it can be used in either case of going into business—that is, predictive reasoning is a useful technique regardless of whether you want to do business part time or full time. But we know that business school entrepreneurship is not the only way to get into a successful business. As we also discussed in Chapter 4, many successful entrepreneurs have shown that they use a "backward" reasoning that was named effectual reasoning by Saras Sarasvathy of the University of Virginia.1 Effectual reasoning begins with a consideration of what resources are available and what restraints there are on those resources. See the following Small Business Insight. SMALL BUSINESS INSIGHT The Scratch Labs Story: Effectual Reasoning at Work • Allen Lim, cofounder and owner, and Ian MacGregor, cofounder and CEO of Skratch Labs. Mary Mecklenburg While Allen Lim, who holds a PhD in exercise physiology, was working with professional bikers as the team physiologist for Team RadioShack, he noticed that many of the riders complained about the sports drinks being used making them sick. When he found that diluting the drinks did not alleviate the problem, he began adding Alka-Seltzer Gold tabs (basically sodium citrate) to the diluted drinks. This did improve the situation, and Allen decided to do some further experimenting. He teamed with Ian MacGregor, a retired American road racer with two Under 23 bicycling National Road Race championship wins. Together, they began to experiment with creating their own sports drink mix, aiming to create a recipe that first was an effective hydrator, second tasted good, and third did not make users ill. Soon they had a formula that did all three, and they began making and distributing the mix. Initially, they used food-grade plastic buckets and a borrowed paint agitator to make the mix. This manual process was not sufficient to meet growing demand for the product, but neither could they find a commercial producer who would make the product for them in the relatively small quantity that they could sell. This quandary was answered by a bit of good luck. Lim happened to meet Andy Rodriguez, president of All American Seasonings who just happened to be a bicycling enthusiast. Although Skratch Labs needed quantities that were not large enough

to be economical for All American Seasonings to make, Rodriguez agreed to a trial contract, with Lim throwing in a deal sweetener in the form of a yellow jersey from the 2006 Tour de France autographed by Floyd Landis. With the guarantee of sufficient product, Lim and McGregor continued their guerrilla marketing, going as far as handing out samples to bicyclers heading north out of Boulder, Colorado, on training rides. Today Skratch Labs has a full line of hydration products, energy bars and chews, recovery mix, and of course, tee shirts, a cookbook, and gear for serious athletes.2 If you think back to the PROFIT model in Chapter 3, you will realize that all entrepreneurs have at least four sets of resources immediately available to them: (1) financial—access to capital, (2) organizational—their own skills and abilities, (3) technological—their own knowledge, and (4) relational—their network of friends and business associates. An entrepreneur is using effectual reasoning when he or she begins to imagine what can be accomplished with the resources at hand. Ideas are evaluated for viability, often in a very small way that presents little risk of financial loss. Ideas that work lead to better ideas, plans, and goals. Ideas that fail are improved or thrown away. As the entrepreneur learns from experience and from interaction with customers, vendors, and mentors, it all comes together as a compelling story that serves to enlist others, create buzz, and bring the business to life. Saras Sarasvathy has defined three principles that are critical in the process of effectual reasoning: Affordable loss Strategic partnerships Leveraging of contingencies Affordable loss is the practice of bringing your product or your service to market with the minimum expenditure of capital, effort, and time. As Allen Lim and Ian MacGregor did, entrepreneurs who practice effectual reasoning will attempt to sell a product or service to some customer before it is even complete. They reason that if someone will buy it now, it must be at least potentially viable. Also, they will learn from both the selling process and the use that the customer has for the product. If the idea is a bomb, then the entrepreneur can walk away with very little loss and go on to the next idea without losing more than can be afforded. Page 160 Strategic partnerships can be either formal or informal relationships with other businesses and individuals who can provide support to your efforts at getting into business for yourself. Creating such partnerships early in the entrepreneurial process is often the key to ultimate success. These partnerships may be created intentionally or through serendipity. Lim and MacGregor provide an example of a strategic partnership that was formed at the point that luck and common sense came together. They were lucky to have met the president of American Seasonings who provided both advice and the first commercial-level production. Leveraging contingencies is another way of saying “recognizing and using opportunities.” While still in high school, Jasmine Adams just happened upon the nugget of her successful business. As she told the story, because she was a competitive swimmer, she usually had swimsuits lying around in her room. One morning she messed up applying her makeup. In a hurry, she grabbed the closest thing to wipe off the makeup and to clean her hands. That

just happened to be an old swimsuit. It proved surprisingly effective, so she took some old swimsuits, cut them into pieces, and sewed the pieces into a double-sided square makeup cleaning cloth. Later she entered a business plan competition and her plan won a $10,000 prize. Today she has a business making the wipes while she attends college in Irving, Texas.3 Jasmine Adams's business plan for her start-up, Smudgies, wins her $10,000. ©Margaret Fox Jasmine saw an opportunity, and she used materials (old swimsuits) and borrowed machinery (her mother's sewing machine) to start her business. There are three other important ideas that fit into both the causal and the effectual approaches to entrepreneurship. These are bootstrapping, bricolage, and lean business practices. Bootstrapping got its name from an old description of a person who began poor and through persistence and self-reliance achieved unlikely success. Bricolage, which comes from a French word that means "to putter around," is the practice of making something from whatever you have at hand. In many ways, bricolage resembles the strategy of effectuation in that it means carefully considering the resources available, and then making something from them. Lean business practices refer to systematically eliminating waste of time, materials, and money throughout a business. The term lean first appeared in a 1990 book based on the Massachusetts Institute of Technology's 1980s study on the future of the automobile.4 Bootstrapping—finding a low-cost or no-cost way to do something—is especially important for firms early in their lives because one of the major threats to the survival of new firms is undercapitalization.5 Businesses often run out of money before they become self-supporting. This can happen from a shortage of cash in the business or even from a shortage of cash in the owner's personal life, because for small businesses starting out the business and its owner are often drawing from the same resources. Page 161 Lean business practices include a set of tried-and-true methods that can lessen capital requirements and reduce cash outflows from the business. This reduces the financial risk of start-up and early operations when cash is often scarce. Lean and bootstrapping are similar in that both methods stress finding ways to achieve desired business goals and objectives when start-up capital is limited. Both lean operations and bootstrapping are based on and share three underlying ideas: 1. Waste not, want not.6 That this thought appears in a 1546 book published 18 years before Shakespeare was born tells you just how old this "newest" fashion is. Avoiding waste is one obvious way to achieve this, but so is borrowing something rather than renting it, and renting rather than buying. Making do with an older but free laptop would be another example, as would saving every penny you can. 2. Create, standardize, repeat. About the same time as Shakespeare was writing his famous plays, shipbuilders in Venice were creating ships made of standard parts. Using standard parts made building subsequent ships much faster and easier. You do this when you make a form letter to solicit customers, when you create a cell phone app that thousands of people can download, or when you buy in bulk to save money.

Standardization of business processes leads to significant cost savings, increased competitiveness, and greater customer satisfaction. 3. Keep in touch. Central to lean business practices is being close to your customer. It helps you know if your product or service is doing its job. It alerts you to problems earlier so you can correct them, and it is just a good business practice in general. Customers and their needs change, and to keep up, you need to keep in touch. As you learn what is needed, adjust your product or service to optimally fit needs. Most cell phone apps get updated every few weeks. This is because as the app makers find out about bugs or glitches, they can fix them and get the fixed version out to users. But bootstrapping and lean methods are not identical in either how people think about them or in how people actually put them to use. So it is a good idea to examine each method in some detail. We will discuss bootstrapping first. The key ideas of bootstrapping are simple:7 Do without as long as you can. Cut your personal and business expenses to the bone (e.g., take no salary, work from home). If you need something, see if you can get it for free (like help from SCORE or former professors). If you cannot get it free, then borrow it, barter your time for it, rent it, or lease it before you buy it. If you need to buy outside services, consider offering equity instead of money, but be stingy with this. Before you buy anything, see if you can find a lower-cost alternative (e.g., a printing calculator and a lockbox instead of a cash register). When you do buy an asset, buy it used or at a deep discount, and always ask if you can stretch out your payments to minimize cash flow. If you need money, borrow it from yourself first, then from family, then friends, and after that, borrow from banks, or take credit card advances. Borrow from credit companies only if they are the sole place you can get money. Capture the capital tied up in your house by making first or second mortgages to get money for the business. Of course, you should do this only if you are comfortable risking your house. Minimize debt by using a cash card like American Express, which requires repayment in 30 days, instead of a credit card. Limit credit card purchases and keep your credit balance as clear as possible. Pay off the balance every month, if at all possible. And always, always keep track of your cash! Page 162 The key to making bootstrapping work is maximizing the value of low costs by obtaining free expertise. One way to do this is to set up an advisory board. Zoë Scharf and Joe Fischer, cofounders of Greetabl (see Chapter 7 opening vignette), recognized the value of finding advisers and were surprised at how easy it could be to find experts interested in helping a fledgling business. They were able to obtain lots of help from advisers while keeping their business small. There are many people from whom you can get free expertise for your business, such as bankers, insurance agents, trade and professional association officers, former or retired entrepreneurs, and public business development organizations such as your local SCORE or Small Business Development Center. One area of bootstrapping that is growing quickly is the availability of high-quality free software useful for small businesses. For example, 37signals.com, which has now grown into basecamp.com,8 got started using free

open source programs to build applications such as a project management program, which they offered for free over the Internet. Today, a small start-up can get even more of the tools it needs for free.Table 5.3 in the previous chapter lists several examples of such free programs. Note that in many cases you can use web-based programs (using an Internet connection) or have the free programs reside on your personal computer.9 For more free software explore the Free Software Directory project (directory.fsf.org/) and sourceforge.net. Note that free programs and websites often have limited support. However, many offer help files and discussion groups, and some offer email support if you can wait a day or more. If you choose a free program, consider picking one that offers pay-as-you-go support as an option, or better yet, bootstrap help by picking software or websites already used by friends. What are now called lean methods were developed in Japan in the aftermath of World War II. Because consumer demand was very low in the war-ravaged country, manufacturers could not count on obtaining economy of scale through mass production. Nor could the cost of having high levels of inventory be tolerated. In response to these challenges, an engineer at the Toyota Motor Corporation, Taiichi Ohno, developed what came to be called the "Toyota Production System," or TPS. When the principles of TPS were brought to the United States, they were renamed "lean." The critical insight of lean business practices is the recognition that customers are not willing to pay for everything a company does. If one supplier is wasteful in its production and distribution and attempts to be profitable by pricing its product and service high enough to cover these wasteful costs, other suppliers who are more frugal are given a critical competitive advantage in that they can be profitable at prices lower than those of their wasteful competition. Those things that people are willing to pay for are called "value added." Things that customers will not pay for are subsequently referred to as "non-value added." It is just the nature of things that non-value-added practices eat up resources without providing any return for the owners of a business. Thus they are waste. Lean principles started with a statement of seven areas of manufacturing in which non-value-added activities can take place. There are seven sources of the waste that lean management seeks to prevent (see Figure 6.1). FIGURE 6.1Lean Business Practices: Seven Sources of Waste Although lean business practices have been applied to every phase of business operations, the set that you will find most interesting was developed and published by Eric Ries in his 2011 book The Lean Startup. The primary focus is to quickly produce what Ries calls a "minimum viable product." Of course, this approach applies to services as well as physical product. The minimum viable product is an early version that allows you to very quickly determine if there is a sustaining level of demand for your product. You collect feedback from your early customers, gaining "validated learning" about the business in its earliest days. Ries provides the example of Zappos, the world's largest online shoe retailer. He tells how the founder, Nick Swinmurn, began with a very small experiment to find out if

people were willing to buy shoes online. Swinmurn took pictures of shoes in local shoe stores. He then posted these photos online. When a customer ordered a pair of shoes, he went to the local shoe store, purchased the shoes at full retail price, and shipped them to the buyer. In this way, Swinmurn validated the viability of his vision for a business at very little cost and risk to himself.10 Page 163 Because most beginning entrepreneurial businesses have limited resources, including cash, time, and experience, it is important that the resources that they do have be used very carefully. You can help ensure that you will have enough resources for success by carefully planning how you are going into business, then following the proven techniques of effectual planning, bootstrapping, bricolage, and lean business processes. LEARN MORE ONLINE You can learn more about the topics above at these sites: Reasons for bootstrapping: www.entrepreneur.com/article/315208 Introduction to lean, six sigma, and lean six sigma: www.greycampus.com/blog/quality-management/a-brief-introduction-to-lean-and-six-sigma-and-lean-six-sigma

The Five Paths to Business Ownership 6-2 Describe five ways that people get into small business ownership. Despite the many unique stories that people tell about how they entered into business, when we examine enough of their stories it becomes evident that there are commonalities among them. In general, we find that every story of business entry can be placed into one of five general paths: ACE Hardware: Jill Braaten/McGraw-Hill Education The entrepreneur started a completely new business. Purchased franchise rights to an existing business. Bought an already operating business. Worked in a small business and eventually gained ownership. Inherited a business from a family member. Page 164 But, of course, this is not the whole story. Starting a business, franchising a business, and buying a business may be done as either a part-time or full-time enterprise. The decision of whether to jump in full time, or to dip your toes in the water by deliberately keeping your business small to start will require making many different decisions—how to plan for the business; how to finance it; what its physical location should be; how you will market it, and many more. So, let's examine the basics of each of these five paths, then take a look at the pros and cons of starting on a part-time basis, or jumping in full time from the get-go.

Starting a New Business 6-3 Compare the rewards with the pitfalls of starting a new business. Starting a new business is at once the riskiest path into business and the path

that promises the greatest rewards for success. The success rate of start-up businesses is a matter of some controversy. As we note in Chapter 1, numerous rigorous studies have found that fully 69 percent of businesses are still going after 2 years, 51 percent are still going after 5 years, 34 percent after 10 years, and 25 percent are still operating after 15 years. Also, studies show that those businesses that get help last even longer. Eighty-seven percent of start-ups that begin in business incubators are still in operation 5 years later,11 and the survival rates for students from entrepreneurship programs and entrepreneurs seeking help from Small Business Development Centers are about twice that of businesses in general.12 Even for those who get help in starting their business, one must admire the courage and optimism of a person who chooses to start a new business (see Figure 6.2). Despite the rather high failure rate, creating a start-up is not, as some maintain, a triumph of hope over reality. Many businesses that end do so not because they failed, but because the owner took advantage of a better opportunity.13 The rewards, both financial and personal, of starting a successful new business can be most impressive. FIGURE 6.2Survival Rate of Start-Up Businesses Page 165 Advantages of Start-Ups There are many reasons that people choose to start a new business rather than purchasing an existing business, franchising, or being an employee: When you start a new business, you can "do it your way." There are no existing rules, processes, or culture that will be difficult to change. You will begin with a "clean slate." There are no existing employee problems, debts, lawsuits, contracts, or other legal commitments that must be satisfied. You have the opportunity to use the most up-to-date technologies. There are no "legacy" locations, buildings, equipment, or software that can hamper productivity. You can provide new, unique products or services that are not available from existing businesses or franchises. Existing businesses and franchises exist because of their success in providing proven products and services. You can deliberately keep the business small to limit the size of possible financial losses. You may take time to perfect your product, services, and processes. Disadvantages of Start-Ups Offsetting the advantages of starting a new business are several disadvantages (see the Small Business Insight): Your start-up business will have no initial name recognition. The lack of an accepted brand can put off potential customers. A start-up will require significant time to become established and provide positive cash flows. A start-up can be very difficult to finance. A new business will not have the existing assets, sales, and cash inflows that can be used to obtain financing for the business. A start-up usually cannot easily gain revolving credit from suppliers and financial institutions. A start-up may not have experienced managers and workers. Your start-up business will be faced with training employees and obtaining management support. SMALL BUSINESS INSIGHT A Failed Start-Up—EventVue While still in college, Josh Fraser and his roommate, Rob Johnson, were contracted to develop a social networking app for a single business conference. The resulting product used information

from the attendees' registration, thus achieving 100 percent inclusion for the conference.14 Information included profile pictures, biographical information, and tags to allow users to sort on common interests, sessions to attend, and so on. The partners put together a presentation of proposed features and were accepted by Techstars which provided mentoring and seed capital in the amount of $10,000. One of the mentors, Noah Kagan, agreed to use the product in an upcoming conference that he was producing. This led to a successful angel funding round in which approximately $500,000 was raised.15 EventVue was on its way. But sales did not materialize. The product, as designed, worked only among registered attendees of any specific conference. Although the app was popular with conference attendees, it did not provide conference organizers any financial advantage. Rob Johnson wrote: Instead of investing in the production features to [enable] EventVue directly driving people to events (hindsight: mistake), we immediately went out and tried to sell the social network tool to conference organizers.16 The firm was rapidly running out of capital. Josh and Rob made a last-minute Hail Mary pass by attempting to address the issue of proving that the app had value for conference organizers who were the actual paying customers. Development proved to be much more difficult than the partners expected. Again they attempted to sell the app "as is," only to see sales remain elusive. As Rob wrote, "It really is too little, too late."17 Starting a New Business in an Existing Field The vast majority of start-up businesses are "me-too" enterprises. The business idea is simply to create another occurrence of a common business: a hair salon, restaurant, bar or lounge, rock band, sign company, plumbing service, yard care, and so on. Starting a copycat business provides some protection from business failure. It is not necessary to define the business to the market because everyone knows what a hair salon, restaurant, or lounge provides. On the other hand, this type of start-up can be very difficult to differentiate from other similar businesses. Often, the only competitive advantage may be the location of the start-up. This is why owners of common businesses go to so much effort to try to make a difference between their business and other, essentially identical, firms. An example is how Morton's of Chicago and Ruth's Chris Steak House operate. Careful sampling of each firm's steaks reveals no significant difference in price, quality, tenderness, size, or taste. The restaurants have similar menus and wine lists. Each, however, has distinctive interior decorating and presentation of its meals. Morton's brings a selection of huge uncooked steaks to each table for patrons to make their choices. The cooked steaks are served on oversized china plates. Ruth's Chris provides equally large steaks, selected from a printed menu, served on plates that are heated to a high temperature and coated in butter to create the trademark "sizzle." Page 166 The specific concept that leads to a start-up business usually comes from the experience of the person starting the business. Two-thirds of all start-ups are based on ideas from prior work experience, hobbies, and family businesses.18 These businesses are generally more likely

to succeed than are businesses based on ideas from other sources. Research into the indicators of successful start-ups shows that one of the best predictors of success is the level of experience of the founders. Random events, suggestions from friends and associates, and specific education courses are the sources of only a relatively few start-up ideas. Increasing the Odds of Start-Up Success The probability of creating a successful start-up is increased greatly when the founder has certain attributes and when the founder takes certain actions. Doing the following things has been shown to be the most effective route to success (see Exhibit 6.1). EXHIBIT 6.1Top 12 Indicators of Start-Up Success Start the business in a business incubator or accelerator. Take part in a mentoring program. Have a detailed start-up budget. Produce a product or service for which there is a proven demand. Secure outside investment. Start with more than one founder. Have experience managing small firms. Have industry experience. Have previous experience in creating a start-up business. Choose a business that produces high margins. Start the business with established customers. Build trust in your "story." Start the business in a business incubator or accelerator: Business incubators and accelerators are organizations that provides financial, technical, and managerial help to start-up businesses. Most incubators are associated with economic development agencies, don't take equity in your business and are integrated into the community. Most accelerators take an equity stake in your business in return for a small amount of your stock, and are privately owned. Both connect entrepreneurs to angel investors, public grants for seed money, and technology support. Business incubators and accelerators are created to strengthen the local economy by helping create jobs through the establishment of successful small businesses. But incubators do much more than just create new jobs. They aid in the commercialization of new technologies, the revitalization of distressed neighborhoods, and the creation of wealth. The best incubators provide inexpensive office space with full-time on-site managers who can assist the entrepreneur in many ways. Incubator participants share common office services, such as telephone answering, and production and copying of documents. Perhaps most important, incubators provide legitimacy by furnishing the business with a location and with established business processes. Page 167 Take part in a mentoring program: Successful business owners and corporate executives do well by doing good. They can, by helping others, in a way repay the many people who helped them achieve success. Executive volunteers contribute their time and energy to assisting start-up and struggling small businesses as a public service. Because of their experience, mentors can help you avoid mistakes and make good business decisions. Have a detailed start-up budget: The start-up phase is usually the most difficult time you will have in business. You are required to make myriad decisions concerning location, product, target market, promotion, sales, and all the facets of starting and operating a business. And you must juggle all these demands while simultaneously seeing that you have enough cash. A

detailed start-up budget provides a road map for necessary spending during the startup phase, when cash inflows are likely to be small or nonexistent. Companies that carefully plan their start-up activities and avoid any unnecessary spending are much more likely to succeed. Produce a product or service for which there is a proven demand: It is an unfortunate fact that most new products and services fail to gain acceptance. NewProductWorks of Ann Arbor, Michigan, maintains a “failed product museum” that contains samples of over 73,000 items, all of which were commercial failures. During the dot-com bubble of 1998–2001, many businesses started with novel and completely untested products and services. Examples are Beenz.com, which was started to facilitate Internet transactions; webvan.com and shoplink.com, both of which sold groceries online for home delivery; and estamp.com, which offered online purchasing of U.S. postage, to be printed on the user’s printer. All four of these businesses failed to gain success with their products. None of these businesses survived the dot-com bust of 2001, although the domain and patents of e-stamp.com were purchased by the currently operating company stamps.com. Large corporations, such as Procter & Gamble or Sony, spend millions of dollars annually testing the market acceptance of new products. Despite their huge resources and years of experience, they regularly introduce products that fail. (Are you old enough to remember “New Coke”?) Your start-up business will not have either the experience or the resources to absorb the loss from product failure. By producing a product or service for which there is a proven demand, the risk of product failure can be reduced or eliminated. Secure outside investment: Securing outside investment accomplishes two things: First, the process of obtaining investment funds means that your business will be critically examined by outsiders who have no vested interest in your idea, product, or service. Second, the fact that you were able to convince outsiders to invest in your business indicates a level of belief in the business and you that provides legitimacy. Page 168 Start with more than one founder: Starting with more than one founder provides the business with more experience, skills, and resources than can be furnished by a single individual. Having more founders in the business also provides an opportunity for synergy, in which the business results are greater than the sum of the input. Multiple founders can also provide a forum for examining ideas, evaluating information, and making good business decisions. Have experience managing small firms: Managing a small business requires attention very much like that displayed by a person spinning plates on sticks. As a performer must move quickly from plate to plate, many demands of small business management require that you have the ability to quickly move from task to task, without allowing any task to ultimately go uncompleted. The process can be overwhelming for inexperienced managers. Those entrepreneurs who have experience in small business management are more likely to be able to meet the many simultaneous demands of guiding a successful start-up than would a person new to small business. Have industry

experience: Each industry has its own peculiarities. Only through experience can you learn the methods, sources, and markets for any specific one. Even simple tasks, such as buying necessary material, can be nearly impossible without industry knowledge. For example, suppose that you plan to start a quality steak house, similar to Ruth's Chris or Morton's of Chicago. Where do you buy prime beef of the required cut and quality? How do you cook the meat? Or, consider making high-tech, lightweight bicycles. Where can you buy titanium tubing? What does it cost? What do you need to cut, shape, and weld it? Are bicycles sold through wholesalers? Are they sold directly to bicycle shops? The less you know about something, the easier it appears to be. A true expert makes a task seem effortless. Watching Tiger Woods play golf might lead you to believe that it is an incredibly easy game. Just stand up, hit the ball, and watch it fly to the green. Sure it's easy: So why do fewer than 2 percent of golfers ever make a course par? The same is true of business. Businesspeople, such as Michael Dell, Scott McNealy, and Warren Buffett, make the process of succeeding in business seem effortless. But if you have been in the business, you know better. Being experienced won't make your start-up easy, but at least you have firsthand knowledge of how your industry works that will make your task easier. Have previous experience in creating a start-up business: "Nothing succeeds like success." In the 150 years since Dumas made this famous statement, it has come to be an unquestioned part of our language. It is just succinct enough, just truthful enough, to seem like a universal truth. For entrepreneurs, it is fortunate that the statement is also not completely true. Although one may learn from successes, most learners acquire expertise through a process of repetition, which only occasionally results in successes. One study of entrepreneurs who had successfully created a start-up business found that on average an entrepreneur suffered three start-up failures before achieving success. Thus it is more nearly correct to state that no entrepreneur succeeds without having prior experience in failing. Choose a business that produces high margins: High margins, the amount by which sales prices exceed product costs, provide a buffer for lots of mistakes. The single greatest hurdle to a successful start-up is obtaining and maintaining sufficient cash to support both operations and growth. When margins are low, loss of any one sale or customer has an immediate effect. However, the problem of replacing the lost margin is much easier if you have to make only one or two sales or get one or two new customers to make up for the lost business. Start the business with established customers: When you start with established customers, you know that you will immediately have cash inflows. There are basically three ways that you can go about obtaining committed customers prior to start-up: (1) You can start your new business as a spin-off from your current employer's business, (2) you can start a business to specifically go into competition with your employer, or (3) you can start a business to subcontract services to your employer or to other established businesses.
  Creating a spin-off is a regular business practice that is done by businesses of all

sizes and at all stages of development. Some spin-offs are created to get rid of “non-core” activities. By disposing of the non-core activity, the parent firm reduces capital requirements and provides a tighter focus for management on the remaining businesses. Other spin-offs are created when the parent lacks either the interest or the resources to pursue the opportunity. By being spun off, the start-up can gain access to resources other than those of the parent. Going into competition with your current employer is also a common practice. Of course, this almost always results in resentments and often ends in lawsuits over issues of trade secrets, rights to intellectual property, and abridgment of contractual provisions. You will have to make difficult ethical decisions. From a legal point of view, the contract between employer and employee is satisfied when all wages and other benefits have been paid in return for you accomplishing the tasks for which you were hired. Absent a specific contract providing otherwise, neither party, employer nor employee, is obligated beyond this exchange. However, not so easily answered are the questions: (1) Is it ethical to use your employment to build relationships with customers that subsequently can be used to start a new business? and (2) Is it ethical for you to use knowledge and skill received through training and education furnished by your employer to go into business competing with your employer? Subcontracting services to an existing business is somewhere between doing a spin-off and starting a competing business. Services that are often contracted include sales, janitorial services, accounting, research, and product development. It is a common, accepted practice for the contractual relationship to be created prior to starting a business. Build trust in your “story”: Building trust is essential to the success of all start-ups. You must be able to convince suppliers, employees, and, most importantly, customers that the business is now successful and will be in the future. Not only is there an understandable reluctance for people to be associated with a potential “loser,” but customers, vendors, and employees all take risks by doing business with an unknown and unproven start-up. Suppliers are often reluctant to deal with start-ups, even if you make your purchases in cash. Most new businesses are small compared to established businesses in the same industry. There is a good reason why you, as the owner of a new business, would prefer to make numerous orders of small quantities of the goods and services you need. Doing so reduces cash flow requirements and reduces the risk of your being stuck with old or obsolete inventory. For the vendor, however, accepting your frequent small orders greatly increases the cost of providing goods and services to you. Most vendors, especially wholesalers, work on very small margins. The cost of accepting and filling numerous orders for a new customer may well make such business unprofitable. It is therefore essential that the vendor believes in your eventual success and that you will become a valuable customer in the future. Employees take on significant risks when they go to work for a start-up business. Not only may the start-up fail, but frequently the cash flow problems of start-ups cause payments for wages to be late or

missed entirely. This is one reason why so many start-ups offer stock options and stock bonuses to employees. The start-up doesn't have enough cash to pay high wages right now, but if it's successful, employees will share the rewards in the future. Customers can similarly be at risk when purchasing from a start-up business. In the event that the start-up fails, there is no recourse for warranty problems, for maintenance, or for upgrades to the product. This risk is especially acute when the product or service of the start-up affects the core business of its customers. For example, the San Antonio Bed & Breakfast Association contracted with a start-up business to develop and maintain a web-based availability and reservation service for the association's members. The start-up failed during the dot-com bust of 2001. When problems with the system subsequently developed, there was no one to fix them. The system was complex and the source code incomprehensible. As a result, the association lost a core service that provided value to its members. Page 170 The issue of building trust in your story is a catch-22. If customers, vendors, and employees do not have trust in the entrepreneur and in the business, quite simply, there is no business. However, there must be a business, or you don't need customers, vendors, and employees. There are several ways for a start-up business to build trust and legitimacy, and these are detailed in Chapter 3. Specific examples for the kinds of businesses discussed in this chapter include obtaining a performance bond that will pay vendors and customers if your business fails. Restaurants, lodging establishments, barbers, hair salons, and other businesses that deal with issues of cleanliness as a business requirement can obtain licenses and join industry groups that perform inspections. Displaying licenses and certificates of inspection provides assurance that you are at least meeting minimum standards. Manufacturing businesses and construction businesses may hire engineers to certify design and construction details. Warranty service can be contracted to an independent company that specializes in providing such services. Rigorously maintaining business procedures that ensure on-time delivery of products and services and on-time payment of bills, wages, and loan payments will, in time, result in the start-up being trusted. LEARN MORE ONLINE Learn more about the topics above at this site: U.S. Small Business Administration offers several free online courses about starting and growing a business: www.sba.gov/learning-center

Franchising a Business 6-4 Compare the advantages and disadvantages of purchasing a business franchise What Is Franchising? Franchising is a legal agreement that allows one business to be operated using the name and business procedures of another. The most ubiquitous franchise worldwide is McDonald's, which has over 30,000 restaurants in more than 100 countries. Approximately 85 percent of McDonald's restaurants are owned by independent businesspeople who operate them in a franchise relationship. The remainder

are company stores, that is, stores that are owned and operated by the McDonald's Corporation.19 Most franchisors are large businesses, most franchisees small: McDonald's Corporation is a large business; McDonald's franchisees are small businesses. Franchises are agreements between two entities, (1) the franchisor who sets conditions and standards and who grants operating permissions, and (2) the franchisee, who pays a fee for the rights, and who agrees to abide by the conditions and standards. Four elements are essential for an agreement to constitute a franchise: The agreement provides the franchisee with a legal right to engage in the business of offering, selling, or distributing goods or services. The agreement provides that the franchisee may engage in business using a marketing plan or system provided by the franchisor. The agreement grants the franchisee use of a brand name, trademark, service mark, logo, or other commercial symbol that designates the franchisee as an affiliate of the franchisor. The agreement requires the franchisee to pay a fee for the right to enter into the business. • Buying one of the top franchises, such as Ace Hardware or Jimmy John's Sandwiches, may be the right avenue for starting your own business if you want to lower some of the risks involved. Many franchised firms have been in business for a long time. Ace began business in 1924 and Jimmy John's in 1983. Franchising gives you the opportunity to cash in on an already developed product that has a proven market. However, drawbacks include having less creative control and greater reliance on your parent company's financial status. Does franchising appeal to you? Why or why not? Jill Braaten/McGraw-Hill Education The value of a franchise is determined by (1) the rights granted and (2) the cash flow potential to the franchisee. Each of these factors can be highly variable from one franchise to another. There are four basic forms of franchising: Trade name franchising is an agreement that provides only the rights to use the franchisor's trade name and/or trademarks. Two examples of this are True Value Hardware and Associated Grocers, Inc. Page 171 Product distribution franchising provides the franchisee with specific brand named products, which are resold by the franchisee in a specified territory. Two examples of this type of franchising are Snap-On Tools and auto dealerships. Conversion franchising provides an organization through which independent businesses may combine resources. An example is Century 21 Real Estate. Individual real estate businesses combine to create a nationwide brand name and enhanced advertising effectiveness. Business format franchising is exemplified by the McDonald's Corporation. A McDonald's franchise includes the right to use McDonald's many trade names, specifications of the product to be sold, operating methods, marketing plan, and national advertising. Franchisees pay to the franchisor both an up-front fee to obtain the franchise rights and a percentage of gross sales. In addition, some franchisors, such as Subway (sandwich shops), sell master franchises that require opening multiple stores within a specified area. Subway describes these franchisees as being "development agents." Master franchisees are required to open a minimum number of stores within a

specified time period, which they may do by selling subfranchises within the development area. Franchising has become the predominant method by which entrepreneurs open new businesses. Depending on who is doing the counting, somewhere between 1 in 10 and 1 in 8 businesses currently operating in the United States are franchised operations. Today, in addition to fast food, nearly every product or service from accounting to zoology is available from franchised businesses (see the Small Business Insight). The most important reason that franchising has become such a successful way of doing business is that a well-run franchise offers a win–win situation for both the franchiser and the franchisee. Franchisers have the opportunity to experience high growth and rapid market penetration without having the requirement to raise capital in huge amounts and to obtain skilled, experienced managers in large numbers. Franchisees are able to partner with an established business that has proven success. Franchising provides an entrepreneur with the opportunity to own a small business quickly while avoiding the high risks of a start-up. As we have discussed, starting a new business from zero is very expensive in terms of demands on the entrepreneur. Most start-ups have limited capital resources and very little room to make business mistakes while learning what is needed to make the business succeed. Franchisers have survived their own start-up phase of business and have determined the "recipe" for success. For this reason, franchises (on average) have lower failure rates and shorter times to achieve positive cash flows and business profits. SMALL BUSINESS INSIGHT Entrepreneur's Franchise 500: Number 11 in 2019 •Jimmy's first restaurant Courtesy Jimmy John's Franchise, LLC James J. Liautaud (Jimmy John) started a sandwich shop in Elgin, Illinois, when he was only 19 years old. He had recently graduated from high school, and in his own words, "I graduated second to last in my high school class, so my options for college were slim to none." His father, an army veteran of the Korean War, wanted Jimmy to enlist. But Jimmy had other plans. He wanted to open a business. Finally, his father made him a deal: Dad would put up $25,000 to start a business. If Jimmy did not make a profit in his first year, then it would be the Army for him. Jimmy found a garage that had been remodeled for a pizza joint. The building was in Charleston, Illinois, in an area full of bars. Jimmy reasoned that the site was perfect. Charleston is a college town, home of Eastern Illinois University. College students drink in bars. When they drink they get hungry and there was Jimmy—selling gourmet subs. Jimmy made that first-year profit and soon bought out his dad's share of the business. A few years later he had 160 sandwich shops, most of them franchised. In 2019, Jimmy John's was ranked 11th on the Entrepreneur Franchise 500 list and there are more than 2,800 Jimmy John's Sandwich Shops, with the number continuing to rise.20 Advantages of Franchising Let's take a look at the specific characteristics of franchises that offer such advantages to would-be entrepreneurs. Having a Fully Developed System of Doing Business Perhaps the single greatest advantage of a franchise is that it comes with a complete business system.

Many franchises are actually “turnkey.” That is, the franchiser oversees (or even manages) the selection of location, the construction of facilities, the acquisition and installation of necessary equipment, and the initial inventory with which to open business. Many franchises come complete with computer software for budgeting inventory control, ordering, point-of-sale computerized cash register, and complete accounting application. So, what does the franchisee do? First, the franchisee must, in one manner or another, pay for all these services. Second, the franchisee will be required to complete training to become intimate with the details of the franchise business system. Third, the franchisee will be required to take an active part in opening and operating the franchise business. Page 172 Franchise Opportunities There are more franchises available than you can count. Unlike finding a small business to buy, finding a franchise is easy. Every issue of Entrepreneur magazine contains the advertisements of dozens of franchisors eager to sell their franchises to you. Entrepreneur.com, the magazine’s website, lists the top 500 franchises. The franchises are listed in rank by the number of new locations opened in the last year. The list of franchises is also broken down into more categories, including: Page 173 Fastest-Growing Franchises Top New Franchises Best of the Best Top 10 Lists Top Home-Based Franchises Top Low-Cost Franchises Top Global Franchises It is interesting that 8 of the top 10 franchises overall are in the service industry. The other two, which happen to be numbers one and two on the Entrepreneur Franchise 500 list, are the fast-food restaurants McDonald’s and Dunkin’.21 If you don’t find one you like in Entrepreneur, the Internet contains thousands of resources for identifying franchise opportunities. A Google search of the web using the terms “franchise opportunity” returned 132,000,000 pages.22 Several of the highest listed pages were the sites of services that offer information concerning franchises of all types. Some offer free services; some charge a fee for information. Among the 132,000,000 sites listed by Google are two U.S. government agencies, the Federal Trade Commission (FTC) and the Small Business Administration (SBA), a British government site, Business Link (www.businesslink.gov.uk), and an Australian site (Smallbusiness.gov.au). Similar government sources are available around the world. Franchising’s industry association, the International Franchise Association (IFA) (www.franchise.org) maintains a website that contains a database of over 800 franchises. The companies listed range from old familiars such as 7–Eleven stores to the really obscure such as Jetblack and Pop-A-Lock. Once you’ve identified a potential franchise, you should perform due diligence, just as if you were buying an operating business. What you are most interested in with franchises is the stability, integrity, and financial performance of the franchisor. You really should interview current franchisees, and you should talk to competing franchisors and their franchisees. If you buy a franchise, you will invest thousands of hours and thousands of dollars. Be sure that it is really an opportunity for you and not just for the franchisor. Legal Considerations Before you sign on the dotted line, you

should personally study two key documents you always receive from a franchisor—the uniform franchise offering circular (UFOC) and the franchise agreement. The UFOC is a standard document franchises use to explain their operations, requirements, and costs to potential franchisees. You can get a guide to help interpret the UFOC at the Federal Trade Commission site. The franchise agreement is the specific contract signed, often incorporating the information included in the UFOC. Both documents are complex. To make sure you have all your bases covered, it is important to get the opinion of an experienced franchise lawyer. You want to know several things, including (1) if and how you can transfer the franchise license to someone else, (2) how you may terminate the contract, (3) how the franchisor may terminate the contract, and (4) what disclosures you are required to make. SMALL BUSINESS INSIGHT When Your Franchisor Goes Broke23 Burt Benepal had just received a most unwelcome call. A business colleague reported that American Hospitality Concepts, Inc. had just declared bankruptcy. This news was delivered Friday the 13th, 2004, just before Benepal was to have opened his first-ever Ground Round Grill and Bar restaurant. Because of the filing, American Hospitality had ordered all company-owned stores closed immediately. Timing could not have been worse for a restaurant. The announcement was delivered just as the Friday evening rush began. Diners were sent home with half-eaten meals in doggie bags. Over 3,000 employees were dismissed without any notice or severance pay. Their final paychecks bounced when they attempted to cash them. Because he was a franchisee, Benepal did not necessarily have to stop work on his restaurant. However, he was under no illusion about the magnitude of the task facing him if he were to stay in business. He already had committed to a capital investment of $1 million. Would customers come to a restaurant that was involved in a bankruptcy? "What should I do," he wondered. In the subsequent weeks, struggling to stay in business, the franchisees organized. They formed a co-op, renegotiated contracts with suppliers, and even introduced a new low-carb menu to capitalize on the Atkins Diet fad. Soon they realized that they were not so bad off. They no longer had to pay royalties or toe the line to meet franchisor requirements. Soon they developed a plan to buy Ground Round out of bankruptcy. On July 7, 2004, their offer to the bankruptcy court was accepted. The franchisees were now the proud owners of Ground Round Grill and Bar, Inc. What about Burt Benepal? He finally opened his restaurant in Richmond, California. He opened five months later than he had planned, but at least it was open and successful. Benepal stated that he expected his first full year of sales to be almost $2 million. He was actively searching for a location for his next Ground Round to be opened in 2005. He had plans to open five more before the end of 2006. In many ways, Benepal was incredibly fortunate. Often when franchisors go bankrupt, franchisees soon follow. Even in the Ground Round case, not all franchisees fared so well. Mike Metz, owner of three Ground Round restaurants in Pennsylvania, had a sales decrease of 20 percent. According to attorney

Craig Tractenberg, several franchisees were forced into involuntary bankruptcy. Similar stories of failed franchisors abound. Have you ever heard of Chi-Chi's, Arthur Treacher's Fish and Chips, 50 Flavors in a Tub, Spud Nuts, or Minnie Pearl's Fried Chicken? Probably not, but they represent just a tiny fraction of the scores of failed franchisors who not only went out of business but who took hundreds of franchisees along with them. If the contract restricts or prohibits you from transferring the franchise to another or if it requires that you achieve unrealistic results to be able to renew, an unscrupulous franchisor has an opportunity to take over your successful business at a bargain price. Your blood, sweat, tears, and life savings will have gone for naught. The contract must specify the conditions under which it may be terminated. There have been lawsuits and allegations of fraud against some franchisors because of contract provisions that prohibit the franchisee from terminating the contract, but give the franchisor permission to cancel without specifying cause or giving advance notice. If you can't terminate the contract in the case that the franchisor goes bankrupt, most likely you will also be forced out of business. See the Small Business Insight for an example of what can happen when a franchisor goes bankrupt. Page 174 Franchising has a long history of unscrupulous and fraudulent operations. Because of the many abuses, the U.S. government and the governments of all 50 states have passed regulatory legislation for franchisors. The minimum disclosure standards that a franchisor must meet are specified by Rule 436 of the Federal Trade Commission. Despite this law, however, abuses and frauds are still being perpetrated. In fact, the third item listed on the SBA's Hot List site is a document that details how to avoid being victimized by scam artists. In college terms, do your homework—know what the opportunity is and who the franchisors are. As is true of purchasing an operating business, caveat emptor. LEARN MORE ONLINE Learn more about the topics above at these sites: Entrepreneur's Franchise Hub: www.entrepreneur.com/franchises Traits needed to be a franchise owner: www.forbes.com/sites/mikethorne/2018/05/18/do-you-have-what-it-takes-to-be-a-great-franchise-owner/#5f12d42e534d

Buying an Existing Business 6-5 Compare the advantages and disadvantages of purchasing an existing business. The second most common way to enter small business management is to purchase an existing business. Buying an existing business has important advantages over creating a start-up. However, purchasing a business has its own unique set of risks. Advantages of Purchasing an Existing Business There are some advantages to buying an existing business: Established customers provide immediate sales and cash inflows. Because the business is already successful, it has proven that there is sufficient demand

for its products and services to operate profitably. Business processes are already in place in an existing, operating business. This eliminates the need to hire employees, find vendors, set up accounting systems, and establish production processes. Purchasing a business often requires less cash outlay than does creating a start-up. The seller will often provide financing that makes it possible for you to buy the business. Disadvantages of Purchasing an Existing Business Disadvantages to buying an existing business include: Finding a successful business for sale that is appropriate for your experience, skills, and education is difficult and time-consuming. It is very difficult to determine what a small business is worth. The value of a small business can never be known with certainty. You must rely on analyses, comparisons, and estimates. Existing managers and employees may resist change. It can be very difficult to convince employees to adapt to new business methods, procedures, and processes that can provide increased profits. The reputation of the business may be a hindrance to future success. Sellers are usually reluctant to tell you about problems that the business has. Business owners are especially sensitive about discussing past disputes and lawsuits with vendors and customers. The business may be declining because of changes in technology. The facilities and equipment may be obsolete or in need of major repair. Finding a Business to Buy The first problem you must solve is finding a business for sale. Of course, you aren't looking for just any business. You are looking for one that is right for your own experience, education, and skills. The things that make a business appropriate for you are like those things that help create a successful start-up. The business should be in an industry in which you have experience. It should be producing a product or providing service that is in demand and that has high margins. Perhaps, most importantly, it should have adequate financing available so you can continue operations and make the business grow. SKILL MODULE 6.1 Finding a Business for Sale Although all businesses are for sale if the price is right, finding that one perfect business is a difficult and time-consuming task. As you will find out by completing this skill task, businesses for sale that are easy to find usually are unsuitable. Businesses that are right for you are downright elusive: Decide what type of business you would be interested in buying. Write a profile of your ideal business to buy, specifying its industry, product or service, size, location, price, and financing. Search the Yellow Pages and the Internet to find business brokers active in your area. Contact each broker and inquire about businesses that meet your criteria. Be honest in your approach. Do not represent yourself as a serious buyer, unless you are one. Obtain copies of the information that the broker has concerning the businesses. Search your local newspaper, The Wall Street Journal, and Barron's classified advertisements for the headings "business for sale" and "business opportunities." On Google, search for "buy a business" to find websites that specialize in businesses for sale. Make a list of businesses that seem to meet the requirements that you wrote down in step 1. Contact the businesses that you have identified. Be honest in your

approach. If you are doing this solely as a classroom exercise, explicitly say so. Remember that while the owner of the business may want to sell it, he or she is undoubtedly very busy and may not want to discuss the business with a student when there is no chance of your actually buying it. Visit a business that is engaged in the industry you have identified as being right for you. Find out the following things: The title and publisher of the journals dedicated to the industry. You can also check out Skill Module 3.1. The primary businesses of this type operating in your geographic area. Conventional business practices: Is business done on credit? Who are the primary suppliers to the business? What are the sales channels of the business (direct sales, catalog, etc.)? How is technology changing in the business? Are there any industry rules of thumb for valuing businesses? Does the owner know of any businesses that are for sale? Obtain sample copies of the industry journals. Examine them for advertisements of businesses for sale. Make an appointment with a loan officer in the commercial loan department of a bank in your area. Describe what you are looking for in a business to buy. Ask if the loan officer knows of any businesses for sale in your area. Ask if the loan officer can introduce you to anyone who might be able to help you find a business for sale. Finally, write and present a report to your class that details the efforts and results of your research. You will greatly increase your chances of finding the right business by using multiple sources. Make some calls: Contact business brokers and ply your own network. You should be actively reading advertising of businesses for sale in newspapers and magazines and on the Internet. You might consider asking your employer if his or her business is for sale. Keep in mind that every business is for sale at a high enough price. If you hear of a business that is interesting, contact the owners and ask what it would take to buy it. Brokers advertise and facilitate the sale of businesses for a fee, usually a percentage of the ultimate selling price. Most states have laws that require brokers to work solely for the interest of the seller and to obtain the highest selling price possible. This creates a conflict of interest between the broker and you. The broker is trying to get the highest price. You're trying to get the lowest. The quality of broker services ranges from excellent to outright rip-offs. Only a few states have any education or licensing requirements, although some, such as Illinois, do require business brokers to register by filing a simple form. Accusations of misrepresentation and fraud by brokers are common in the business press. Page 176 Networking is an excellent way to find businesses for sale. While most businesses are for sale at any time, for competitive reasons most owners do not want to say so explicitly. Because customers, vendors, and employees are likely to feel threatened, openly advertising a business for sale can lead to the loss of revenue, credit from vendors, and key employees. For these reasons, it is common for business owners to make their intention to sell known only to trusted confidants in the industry and in the community. Attorneys, bankers, accountants, and insurance agents all will provide you with information only if they know that they can trust your discretion. You can usually get

solid leads just by telling other businesspeople that you're interested in buying a business. •There is a trade journal for every industry. Sources: Signs of the Times April; Funeral Business Advisor; Fenestration Review. Page 177 There is a trade journal for every industry that exists. The replacement window industry looks through Fenestration Review. The electric sign industry is energized by Signs of the Times. People in the mortuary business bone up with Embalmer and American Funeral Director. The folks who process dead and decomposing animals into usable products digest Render magazine. The construction industry digs Rock and Dirt. No matter what type of business you might be considering, there is a magazine for it. They all have advertisements of businesses for sale. Skill Module 3.1 details how to find professional associations and trade magazines. The Internet also has numerous sites that advertise businesses for sale. A search using Google with the keyword "business" and the phrase "for sale" resulted in over 700 million pages listed. None of the advertisements that were inspected during the research for this book provided the name or the exact location of the advertised business. Rather, the sites have various ways you can obtain additional information. Some provide a link by which you can request more information. A very few listed phone numbers you can call. Others require becoming a member and paying a fee for access. Your current employer is probably a ready source of information about businesses for sale in your industry. Most managers of small businesses are members of formal and informal groups of businesspeople, for example, the chamber of commerce, Rotary, Kiwanis, and other groups that have meetings and provide resources. Also, your employer probably has information about competitors and vendors in the area. Investigating Entrepreneurial Opportunities: Performing Due Diligence Suppose you've actually found a business you'd like to buy. Your job has just begun. Finding an appropriate business is merely the first, and easiest, step in the process. Buying a business is a lot like getting married—it is easy to get into, but if it turns out bad, it's very hard to get out. Now that you've found that "perfect" business, you must make an exhaustive investigation to tell if it is really suitable. Unlike residential real estate, which is highly regulated in the United States, sellers of businesses are not legally required to make disclosures of impairments or deficiencies. If you are outside the United States, your laws may be different. For example, in Canada, sales of businesses for a price less than $200,000 are tightly regulated. Sales for amounts greater than $200,000 are not regulated at all. As in the United States, it is your responsibility to fully investigate the business and to come to your own independent evaluation of its value. Due diligence is the process of investigating to determine the full and complete implications of buying a business. During the process of due diligence every aspect of the business is examined in exacting detail. Nothing is taken for granted. No statement is accepted without evidence. Evidence is, itself, substantiated with sources external to the company. Properly performing due diligence minimizes the risk of failure and maximizes the probability of success by identifying the strengths and weaknesses of

the business. When a business is to be acquired, there is a clear order of steps that should be followed: Conduct extensive interviews with the sellers of the business. Study the financial reports and other records of the business. Page 178 Make a personal examination of the site (or sites) of the business. Interview customers and suppliers of the business. Develop a detailed business plan for the acquisition. Negotiate an appropriate price for the business, based on the business plan projections. Obtain sufficient capital to purchase and operate the business. The first five steps together make up the process of due diligence.24 A basic tenet of business law is caveat emptor, or "let the buyer beware." This does not mean that a seller can freely lie to you about the business. Deliberate misrepresentations can lead to lawsuits and may be prosecuted as fraud. However, except for specific representations by the seller, you are responsible for understanding the condition and the facts of the business. It's kind of a "don't ask—don't tell." If you don't ask the right questions, the seller has no obligation to tell you the right answers. Thus, as the buyer, you must determine how the business is currently being operated, and you must substantiate (or disprove) representations made by the seller regarding the existence and value of assets, liabilities, financial performance, and the condition of the business. Due diligence has two primary goals. First, you are attempting to find any wrongdoing: (1) fraud committed by the owners or managers; (2) misrepresentations of the sellers, such as improperly recognized revenues or expenses; and (3) missing information, including pending or threatened litigation, technological obsolescence of equipment, processes, product, or service, and unpaid taxes. Second, you are trying to find any inefficiencies, unnoticed opportunities, waste, and mismanagement. The first goal is information that greatly affects the value of the business and the advisability of purchasing it. The second goal is how you, as a new owner, can make changes to increase its value. Both goals can give you a negotiating advantage. The first information that you get is usually a set of financial statements. There are four reasons why this is so: (1) the seller usually has financial statements available and incurs little added cost in providing them, (2) you, as a businessperson, are most likely familiar with financial statements and can extract useful information from them, (3) financial statements are accepted as representative of the business by bankers and investors, and (4) financial statements are considered to be indicators of future business results. Financial statements should include (1) a balance sheet, (2) an income statement, and (3) a statement of cash flows. You should also examine the federal and state tax returns for at least the last five years. Information forms for partnerships, corporations, or limited liability companies should be examined also. Any financial statement prepared by or for the seller must be treated with skepticism. Some financial statements that you see will have been subjected to rigorous examination by professionals outside the business; some will have been dashed off by the owner at midnight on April 15. To be believable, the statements must be substantiated by external

sources. When you examine the income statement, you should focus on corroborating the amount and timing of revenues and expenses. Be aware that the income statements of small businesses are commonly misstated. To avoid taxes, owners often charge personal expenses to the business, such as cars, country club memberships, travel, and even home office expenses. On the other hand, when preparing to sell the business, owners are motivated to overstate revenues and understate expenses to show the highest profit. Balance sheet items that are likely to be misstated are intangibles, that is, things that have no physical existence, but rather are legal rights and obligations. Intangibles include accounts receivable, patents, licenses, and liabilities. Assets claimed on the balance sheet must be examined to ensure that they exist and that the stated value is reasonable. Because liabilities are legal requirements to give up economic value in the future, such as debts for borrowed money or merchandise purchased on account, your risk is that there will be liabilities that are not disclosed. Your problem is that you are attempting to prove the absence of something. Once the examination is complete, you should adjust the amounts, contents, and format of the statements to reflect what you have discovered through due diligence. During due diligence you should also try to answer many nonfinancial questions. Why is the business for sale? Who are key employees? What is the extent of obsolescence of equipment and key technologies? What are the prospects for the firm's products and services? What opportunities can the firm reasonably expect to have in the near future? Page 179 Determining the Value of the Business After you have completed a thorough and exacting investigation, you need to analyze all the information you have gathered. This is the time to consult with your business, financial, and legal advisers to arrive at an estimate of the value of the business. Outside advisers are impartial and are more likely to see the bad things about the business than are you. You should make a decision to actually attempt to buy the business only after the evaluation process is complete. It is very difficult to place a value on a small business. The most theoretically rigorous method of valuing an ongoing business, using discounted cash flows, is based on estimates of future cash outflows and inflows, given the change in ownership. Making such estimates is highly problematic. Because of these difficulties, it is common to use other, less rigorous methods to place a value on a business, such as asset valuation, comparable sales, financial ratios, or industry heuristics. Discounted Cash Flow Methodology Discounted cash flow analysis is based on the concept that the longer you have to wait to receive money, the less valuable it is right now. The application of discounted cash flows to business valuation is similar to having an annuity. An annuity consists of some amount of money which is invested to earn interest. The interest that is earned and a portion of the capital invested is then paid back to the holder of the annuity in a series of equal cash payments. In a similar way, when one buys a business, an investment is made. The business then should provide a return sufficient to repay the investment and also provide a

return on that investment. A detailed explanation of the use and calculation of discounted cash flows is presented in the appendix to Chapter 15. Asset Valuation Methodology Asset valuation methods are based on the assumption that a business is worth the value of its assets minus the value of any liabilities. There are two major problems with using asset valuation methodologies. First, such estimates do not consider the value of an ongoing firm over the value of its identifiable assets; for example, the value of an established restaurant over the value of the building, signage, equipment, and fixtures. Second, it is very difficult and time consuming to separately identify and estimate the values of all the assets of a business—imagine a hardware store with tens of thousands of items. There are three methods commonly used to estimate the value of a firm's assets, book value, net realizable value, and replacement value. Book value is the original acquisition cost of the asset, minus all depreciation expense recognized to date. There are three major problems with using book value: The original cost of an asset might bear no relation to its current value—for example, a computer bought five years ago may be worth next to nothing today. Depreciation is an arbitrary, although systematic, method of transferring asset value to expense. Depreciation makes no attempt to measure actual loss of value of an asset. For example, for income tax purposes, a new car is depreciated over a five-year period, where in fact it loses 40 percent of its value when you drive it off the lot, but may well have significant cash value at the end of the depreciation period. Internally developed assets, such as patents, trademarks, and trade secrets, do not have book value. For an example, consider the Coca-Cola Company. Its single greatest asset is its rights to the names "Coca-Cola" and "Coke." However, if you examine the annual statement of the company, you will discover that no value for this right is shown in the balance sheet. To address such problems, you must make adjustments to the value of assets that are obviously worth more or less than their book values. Net realizable value is an estimate of the amount for which an asset would sell, less the costs of selling it. If you were selling a building, the cost of selling would be the money spent on the real estate agent, advertising, and preparing the building for display. Replacement value is an estimate of what an identical asset would cost to be acquired and readied for service. Net realizable value is usually significantly less than the replacement value of any specific asset. Page 180 Comparable Sales Comparable sales of other firms in the same industry are commonly used to estimate the value of a business. This method has two major problems. First, no two firms are exactly alike. Second, there are often no recent sales to use for comparison. But there are online sites like Valuations.com and Bizbuysell.com, or check if your library has access to DealStats (formerly Pratt's Stats) or BIZCOMPS database. Financial Ratios Financial ratios are often used to place a value on businesses because industry ratios are independent of the size of the business. For example, the percentage food cost for the entire Pizza Hut chain is essentially the same as that of an independent pizza restaurant. Using financial

ratios requires that you have an estimate of future income and tax flows. Businesses are never identical. At the minimum they occupy different locations. At the other extreme, they may be different in all measurable aspects: location, size, gross sales, profitability, condition of markets, and physical assets. The best source of industry financial ratios is from data collected by industry associations or industry statistic providers, such as Bizminer or Bizbuysell.com. Some of the commonly used ratios are: The earnings multiple ratio is simply firm value divided by actual or expected annual earnings. Multiplying forecast earnings by the earnings multiple provides a quick estimate of firm value. You can try using this approach with the valuation calculator at www.bizex.net/business-valuation-tool or see how it is used for computing Private Company Comparables in the Valuations.com Skill Module 6.2. Page 181 Pretax return on assets (ROA) is calculated by dividing earnings before income tax by asset value. Multiplying forecast earnings by the pretax ROA gives an estimate of net asset value, or total asset value minus liabilities. Net income to equity is determined by dividing income by the equity owners have in the business. To estimate firm value, you must multiply your estimate of future earnings by the ratio. This ratio, however, can seriously understate firm value because it does not include the value of borrowed capital. Net income to (equity + debt) is an extension of net income to equity that explicitly includes the value of borrowed capital as a component of firm value. Page 182 Income capitalization is calculated by dividing projected net income excluding depreciation, interest, and owner draws, by the best return that you could expect to obtain in other investments. For example, if you are forecasting that you will have a net income of $66,000 and your cost of capital is 11 percent then the estimated value of the business would be $600,000 ($66,000/0.11). Industry Heuristics Industry heuristics are simply rules of thumb that are commonly used to estimate firm value in relation to some easily observable characteristic of the business. Industry heuristics are similar to comparable sales in that they represent the combined experience of people active in the industry. For example, in the bed and breakfast and small inn industry, two heuristics are often used to estimate the value of an operating inn. The first is that an inn should sell for approximately $100,000 per rental room. The second is that an inn should sell for approximately four times its annual gross revenue. Industry heuristics can be amazingly accurate. In a recent survey of 300 inns, the Professional Association of Innkeepers International found that the average selling prices of inns between 2000 and 2002 was $99,300 per guest room. The average gross revenue multiplier was 4.3.25 Similar heuristics exist for nearly all industries and are usually available from the group's trade association. You've seen how to find associations in Chapter 3. You can also look at online sources like bizstats.com/reports/valuation-rule-thumb.php 26 or Business Valuation Resources (www.bvresources.com) for selected heuristics. A useful website for making basic valuation efforts is valuations.com, which prepares free reports on a business's valuation

based on key information you input (sales, growth rate, and industry).Skill Module 6.2 shows you how to create and interpret those reports. SKILL MODULE 6.2 Estimating a Business's Valuation on Valuations.com Valuations.com is a free website that lets you create a valuation report for any sort of business. Getting started requires only three pieces of information: the business's industry, its annual sales for the latest year, and a general idea of the growth rate of the business. You'll need to create a free account first. For this example, imagine an online retailing business selling $50,000 worth of products last year, with pretty stable sales. Typing "online sales" into the "What does your company do?" brings up a number of options. For our business, the closest is "Electronic Shopping and Mail-Order Houses." We'll pick "Stable Company" for the growth rate, so the initial screen looks like this: Valuations.com Choose "View Report." On the resulting report, you can see options for the discounted cash flow (DCF) model described above as well as two versions of the comparable sales approach. Given we are talking about small businesses, we'll choose the "Private Company Comparables" tab, which gives a suggested valuation of $18,422. This number is higher than Valuations.com's computed estimate of $12,000 because of differences in the data sources. Note that you can adjust the descriptions for your firm with the sliders toward the top of the page for profit margins and estimated annual growth rates. Valuations.com These Private Company Comparables are based on actual sales of existing companies. There isn't a straightforward way to assess the valuation of a new start-up. But an imperfect workaround is to take the numbers from year 3 of your business plan's financial projections, and use those to get an idea of the valuation of your proposed business, if you reach your projected sales, profit, and growth levels and you don't have any other major problems facing the firm. Structuring the Deal 6-6 Explain four methods for purchasing an existing business. A buyer and seller get together to negotiate the final price for a business. The buyer should have performed the due diligence procedure and be confident about the assessment of the condition and value of the business. Along the way you, as the buyer, should have decided on the absolute highest price that you would be willing to pay. That highest price is called your point of indifference27 in the negotiation process. The term comes from the idea that once that price is reached, you should be indifferent as to whether or not a deal is made. Of course, you'll open negotiations with a price substantially lower than your point of indifference. The purpose of opening low is twofold: (1) you want to make the purchase at the lowest price possible, and (2) you recognize that the seller assumes that any opening offer is less than what you are actually willing to pay. A low opening bid allows both parties room to reach a compromise satisfactory to both. In addition to negotiating for price, you also negotiate about the terms of the sale. When you are buying a business, everything is negotiable, not just the price. In fact, the terms of the acquisition, such as seller financing, payment periods, noncompete agreements, and the exact details of what is being acquired, all

interact to affect the price that you are willing to pay and that the seller will accept. There are four basic ways that a business may be bought: (1) you may buy out the seller's interest in the business; (2) you may buy in by acquiring some, but not all, of the ownership; (3) you may buy only the key assets of the business such as the inventory or equipment of the business, and not the business itself; and (4) you may take over a public business by buying a controlling interest of its stock. Buyouts Buyouts are restricted to businesses that have a formal legal form of organization, including corporations, limited liability companies, and some partnerships. Legal business organizations are artificial entities that exist separately from the owners. Buyouts are accomplished through purchasing the ownership interest in the entity. Technically, partnerships and sole proprietorships do not exist separately from the owners and thus cannot be purchased. Rather, the assets of the business must be purchased and the liabilities assumed in a process called key resource acquisition or bulk asset sale. The subsequent business is considered to be a new entity different from the selling entity. In practice, partnerships can continue in existence despite a change in ownership. Sole proprietorships cannot. Page 183 The primary advantage to a buyout is simplicity. The seller must only transfer his or her stock to the purchaser to complete the transaction. The business continues as an entity, owning its assets and maintaining responsibility for its liabilities. The primary disadvantage to a buyout is that all liabilities are transferred, including potential lawsuits that arise from actions and transactions that took place prior to the change in ownership. This has, as in the case of the widespread class-action suits concerning asbestos, led to bankruptcy for the purchaser. A buyout may take place all at once, with all stock being transferred at a single point in time. Sometimes buyouts are made with ownership being transferred over some agreed-upon time range. Buyouts made by employees are examples of changes of ownership over time. Employee buyouts were made legal in 1974 when employee stock ownership plan regulations were codified into law. An employee buyout occurs when the owners of a company sell a majority of stock to the employees through an employee stock ownership plan (ESOP) as was provided in the 1974 legislation. ESOPs are complicated transactions that require highly skilled professionals to implement them. Buy-Ins A buy-in results when someone acquires only part of the ownership of an existing business. Any amount of ownership may be considered a buy-in, as long as less than 100 percent of the ownership is transferred. Buy-ins can be made in any form of business. Technically, if one buys into a sole proprietorship, it becomes a partnership. Corporations and limited liability companies may continue without a change of the form of entity. There are two advantages to making a buy-in: (1) a buy-in allows the purchaser to leverage inside knowledge, and (2) it aids in keeping key employees. The seller and the managers of a successful business, by definition, have experience in operating that business profitably. The buyer, no matter how expert, does not have the same depth of knowledge of the business being purchased. One great threat to

the buyer of a business is that employees who are key to its operations will leave the business. Keeping the current owner as an active participant of the business reassures employees that large changes are not likely to occur. The disadvantages of a buy-in are the same as the advantages: the prior owner and management remain with the business. This often causes friction when the new owner wishes to make changes, and the old owner and managers do not. Key Resource Acquisitions Key resource acquisitions, also called bulk asset purchases, are the only way a sole proprietorship may be purchased. This technique may also be used with any other form of business. As the name implies, key resource acquisitions comprise purchasing only the assets of the business. Usually, the seller will keep any cash and receivables and will retain responsibility for some short-term liabilities such as notes payable. As we saw earlier, the most difficult issue in purchasing a business using this method is assigning a value to the intangible assets, such as the value of the business name, the value of having an ongoing business, the value of established relationships, and so forth. The value of the business in excess of the value of the identifiable assets is called goodwill. You should attempt to recognize a minimum amount of goodwill. One advantage of business ownership is the ability to shelter income by using noncash deductions to reduce income taxes. Prior to 2002, a business could reduce income taxes by deducting goodwill over a period of years. However, businesses purchased after December 15, 2002, are prohibited from deducting for goodwill.28 Thus the more of the business's value that is recognized as goodwill, the less income can be sheltered from income tax. Key resource allocation provides one important advantage. Because only the assets are acquired, the subsequent business, regardless of its legal form, is not responsible for any of the acts or transactions made prior to purchasing the business. Although this does not completely relieve the successor business from all prior liabilities, it does protect it from action concerning any noncollateralized liabilities, such as a line of credit or a personal loan of the seller. Takeovers Page 184 Takeovers are possible only in businesses that have stock that is freely transferable without the permission of management or other owners. In other words, only corporations and certain partnerships can, under any circumstance, be acquired in a takeover process. A takeover comprises purchasing enough of the target business's stock to gain control of the board of directors of the business. In a takeover, the buyer (often called a raider) seizes control of the business without the permission of all owners. Sometimes only a few owners are involved, as takeovers can often be accomplished by purchasing or even borrowing a relatively small percentage of outstanding stock. Takeovers are hostile events. There is the threat that current management will be replaced. Occasionally, the raider will explicitly state that the intention of the takeover is to sell off portions of the business, or even to liquidate it completely. In these circumstances, current management is likely to make strenuous efforts to prevent the takeover from occurring. Because of the requirement that stock be

freely transferable, only a few small businesses are vulnerable to hostile takeovers. Accomplishing a takeover of a small business is likely to result in the loss of key employees and the resentment and resistance of those employees who remain. As a result of these limitations and problems, takeovers are usually done on medium to large businesses. Only rarely does anyone acquire a small business through a hostile takeover.

Inheriting a Business 6-7 Explain the issues of inheriting a family-owned business. Unless your parents or grandparents are small business owners, you might think that this section does not apply to you. However, the fact that you are taking this course indicates that you have some interest in becoming a business owner yourself. Thus, someday you may well find yourself on the other end of the inheritance process: You may be the founder who wishes to pass your business to your heirs. Whether you are inheriting a business or bequeathing a business, you face the same problems of passing ownership. Only your point of view changes. In Chapter 2, we introduced the topic of family businesses. As we pointed out there, family-owned businesses make up a huge percentage of all businesses in the United States. In fact, this pattern holds throughout the world. Ownership of all these millions of businesses can potentially be passed through family succession, for example, by being inherited in one form or another. Family Businesses Succession Inheritance is not restricted to parent–child or grandparent–grandchild. Family businesses can be, and often are, passed from the current owner-manager to nieces, nephews, cousins, or in-laws. One of the most difficult things that you will ever have to do is make a successful ownership transition. Turning over management authority is not easy for most founders, nor is it easy for the heir of the founder to assume the authority. However, if the firm is to prosper, you've got to find a way to do it. Research shows that family-owned businesses usually fail after the death or retirement of the founder. Fewer than 30 percent are successfully transferred to a second generation. Fewer than 13 percent succeed long enough to be inherited by the third.29 Family businesses that successfully make the transition do so by taking specific actions to organize the business and ensure that it can run profitably when the founder is gone. Developing a Formal Management Structure To make the transition, you will have to establish a formal management structure. You will need to develop a comprehensive business plan that states clear goals and objectives. Most difficult, you must be able to clearly see the strengths and weaknesses of family members who will remain in the business.30 You must then hire professional managers to run those functions that family members cannot. Once successors have been selected, they must be educated in all parts of the family business to develop experience and skills. Whether you are the founder or the successor, you face an overwhelming task. The founder must impart his or her unique knowledge, skill, and experience that has made the business successful. The successor

must learn all these things. While this is happening the founder and successor will have to work closely together.31 There always will be issues of who is in charge. No matter the skills and experience of the successor, as long as the founder is active in the business, many people will automatically turn to him or her for decisions. Succession Issues for the Founder Page 185 To ensure that your business survives after you're gone, you must be proactive in bringing selected family members into the business as soon as you can.32 The issue that must be faced in this process is selecting the appropriate family members. All members of the family business, whether being active in management roles or simply being silent owners, should have an open and ongoing dialog about the strategy, goals, and operations of the business. If you, as the founder-manager, take part in family dialogs about the business, you will gain insight into their values, ideas, and goals. Although family members usually share a set of basic values, there is inevitably some diversity in motivations and personal goals. This diversity can be a positive advantage when it brings new thinking to the management of your business. On the other hand, it can be a source of divisiveness that can lead to a failure to cooperate or even to angry confrontations to the point of mutual lawsuits among family members. Handling conflict in families is a topic covered in Chapter 18. To avoid having the diversity of values, goals, and motivators from becoming the source of such intrafamily strife, you and the other family business members should respect one another's differences by: Being certain that all family members know and accept that they are not forced to enter the management of the business if they don't want to. Providing each member of the family business with the opportunity to obtain education and experience outside the business. Working in other businesses will provide knowledge and skills that cannot be provided solely from within the family business. Allowing each family member who does wish to enter the business to find out and do those functions and activities that he or she does best. Not assuming that the leadership of the business must come from within the family. Being part of the family does not guarantee business leadership skills. Once you have brought a family member into the firm, you must provide opportunities for learning and growth. This is achieved by deliberately and methodically sharing both responsibility and authority. Often, the founder of a small business finds it very difficult to give up decision-making authority to family members, especially to children and grandchildren. Regardless, you have to "let go" and allow family members that you bring into the business to use their knowledge, skills, and experience to make decisions in the areas where they have special competence. It is only by doing that you and your heirs can develop stronger management skills necessary to ensure the future success of the business. Successfully bringing family members into the firm, allowing them to find their areas of special abilities, and sharing both responsibility and authority for management decision making is an essential first step. Next, you need to set up specific avenues of access among family members to be able to share their ideas and challenges.

One way to achieve this goal is to set up regular “family board” meetings—meetings where each family member listens carefully to the others, and each has a chance to express specific concerns. Openness and regularity in intrafamily communications ensure that you will develop your family managers into a learning community that will benefit from each other’s mistakes and successes. You should write out your specific decisions and desires concerning who inherits what. You should then personally inform everyone who is affected by your decisions. You must also explicitly state the reasons for selecting any one family member over another when there is competition for a specific job in the business. All too commonly the heir not selected challenges the succession after the founder dies. When this happens, the business often fails, and only the lawyers win.33 Succession Issues for the Successor To ensure that the business thrives after you’ve taken over, you must be able to gain the loyalty of other family members, professional managers, and employees. You will be treading a fine line between acceding to the wishes of the founder, and making changes as all dynamic businesses require. When changes are necessary, you should take the time to involve as many of those affected as possible in the decision process. It is important that you neither allow the business to become fossilized—a monument to the founder—nor present yourself in such way that you are perceived as an “upstart”—determined to erase all signs of the founder. Page 186 In the best of all possible worlds, you will have started working in the family business while you were quite young. As you aged and matured, you would have been given increasingly more difficult and important tasks to complete. You would have worked in all parts of the company, from the most menial to the most demanding. As you learned these tasks, you would have been provided the same performance evaluations, training, and mentoring as would be provided to any employee being groomed for greater responsibilities. Such a gradual and growing role in the business goes a long way toward reducing suspicion and resentment of workers that the “boss’s kid” is being given the position despite any lack of competency. (Assuming, of course, that you are actually competent.) As you, the successor-to-be, gain greater responsibility and authority you will also gain experience and skills in the multiple activities and functions of the firm. Although the responsibility for teaching and grooming the successor lies with the founder, you, the successor, have a responsibility to know and to master the areas that are essential to the success of the business. These essential skills include (but are not limited to): Technical knowledge—You must understand the science, technology, and methodology of the industry of which the business is part. Financial knowledge—You must understand the financial needs and resources of the business and industry, and be competent to negotiate with lenders, investors, vendors, and customers. People skills—You must be able to effectively deal with people, with other family members in the business, with employees, suppliers, regulators, and, most importantly, with customers. Leadership skills—You must be able to communicate your vision for the

company to family members and to employees, getting them to “buy in” and make the business goals their goals. Knowledge of your own limitations—Nobody can know and be expert at everything. You must know your weaknesses, and be quick to obtain assistance in those areas. Finally, you must determine just how final authority will be passed to you. Business succession is not always the result of the death of the founder. Often the founder simply realizes that it is time to “pass the torch” to the next generation. Your problem, as the successor, is to understand and to be comfortable with the role, if any, that the founder is to play in the business once you take over. Often, the founder takes an executive position, such as board chair, while the successor becomes chief executive officer. Sometimes, however, strong-willed founders just can’t keep from meddling. When this is the situation it is probably best that the founder leave the business altogether and allow the successor space to create his or her own management style in the business. Ownership Transfer Whether you are the founder or the successor, you certainly do not want to wait until the founder dies to transfer ownership. If you are the founder, once you’re dead, your desires become irrelevant. If you are the successor, once the founder is dead, there is no authority figure who can help with issues of control and strategy. Rather than waiting for the founder to die, you should assist in completing a comprehensive estate-planning process while the founder is still healthy and in charge.34 In most cases, a gradual transfer of ownership is preferable to a single inheritance.35 This strategy may not be appropriate, however, if there are multiple heirs. Of greatest importance is determining who gets voting stock. If the heirs who are not involved in management receive voting stock, issues of who is in control can arise because of jealousy and intrafamily rivalries. There is no easy answer to these issues. In fact, the transfer of ownership is highly complex and is unique to each family business. The larger and more successful your business is, the more complex and difficult the problem becomes. Using experts in law, accounting, and business can help identify the potential problems and help organize solutions. For family business succession plans, using specialists is essential. For family business experts, the major professional association is the Family Firm Institute. There are several organizations for business brokers; you can find them in the Google directory by entering “business broker association.” In any case, it always pays to ask other entrepreneurs and advisers such as lawyers and accountants if they have recommendations and personal experience with these experts. Involving specialists also sends a clear message to creditors and suppliers that both old and new owners are determined to make a success of the transition.

Professional Management of Small Business 6-8 Describe how hired managers become owners of small businesses. As small businesses grow, the requirements of managing them increase proportionately. If a business grows large enough, no matter how

experienced or talented a business owner is, eventually the demands of managing will become too great to be handled alone. At this point, one of two things happens: (1) the business starts to decline, or (2) professional managers are hired to share the management load. In the terms of small business, professional management is not an issue of education, titles, or credentials. A professional manager of a small business is one who has the experience and skills to use a systematic approach to analyzing and solving business problems. These kinds of people are not easy to find. You may have to look to other businesses in your industry for experienced managers who are seeking new challenges and opportunities. You may find such people working for your vendors or your customers. In an ideal world these people would already be working among your employees, people who, because of their individual drive, personality, and skills, have learned your business quickly, and have taken on responsibility and authority. An opportunity for you to get into small business while avoiding the many risks of start-ups or franchises, and at the same time avoid the difficulties of raising capital to buy an existing business, is to go to work for the business as a hired manager. If you have the skills and experience of a professional manager that will allow you to be hired, taking the position will provide a unique perspective of the business from the inside. Should the business prove to be one that you want to own, you are in a position to understand the business's worth and to negotiate terms that make it possible for you to acquire it. Employee managers of small firms are often would-be entrepreneurs. The set of management skills needed to be an effective manager of small business is very similar, if not identical, to the set needed to be an effective business founder or owner. Because of this, it is common for a manager to become an owner—either of your business or of a competing business. Entry into ownership is accomplished through all the ways discussed in this chapter, including leaving employment to start up a new business, buying out or buying into an existing business, or contracting a franchise relationship. There are only five paths of entry into small business management, although the details of how any one person gets started are unique. You may start a business, franchise a business, buy an existing business, inherit a business, or be employed as a manager in a business. Getting into business, for all its difficulties and problems, however, is the easiest part of small business management. Making the business successful and finding a graceful and appropriate way to get out is the true challenge, and that is what we look at in later chapters. 6-9 Identify the choices for exiting a business. How to Get Out of Your Business Here is the flip side of starting a business, that of getting out of the business when the time comes. We briefly discussed some issues that entrepreneurs face when they bequeath a business to their heirs, but in fact, there are even more ways to get out of business than there are to get in. Many small businesses are just "put to sleep" by their owners when a better opportunity occurs. Others are sold—to outside investors, other entrepreneurs, employees, other existing businesses.

It is unfortunate that a few go through formal bankruptcy and liquidation. Figure 6.3 shows the range of outcomes from best to worst. Succession is one of a range of alternatives for transferring or terminating a firm. In any year, there are roughly 900,000 family business successions taking place. In addition to succession, the other way to benefit from the transfer is to sell the business to someone else. There are roughly 1 million business sales each year. In addition to the profitable types of business sales, when the purchase price represents only a token amount, the transfer is called a sell off, and where the old owner gets no payment, in effect giving the firm away, it is called a pass off. These approaches accounted for nearly 40 percent of family business transfers.36 FIGURE 6.3The Hierarchy of Business Outcomes Page 188 Terminations represent about 1.8 million firms a year.37 Closing the business with no outstanding debts is referred to as a walkaway. More than one-third of the closing firms annually take this approach.38 As the owner who is closing the business faces more debts, the typical approach is to arrange a workout, where the owner takes another job and pays offs the remaining debts of the business. More than one-half of all business closings are workouts.39 In the worst case, the owner of a failed business, with too much debt to realistically pay back, faces the prospect of bankruptcy, a legal method for closing a business and paying off creditors in extreme situations. Bankruptcy will be covered in Chapters 13 and 14, and it is very rare with only 22,245 businesses filing for bankruptcy in 2018.40 The smartest entrepreneurs will think about exit strategies from the start, especially those seeking angel or venture capital, because those investors will want an exit to get back their investments and profits. In reality, though, most entrepreneurs don't take outside investment, and for them, exiting the business comes up late in the process. But even starting late, it is possible to plan and take steps to improve your chances of selling the firm.41 Of the 4 million firms that will change hands or close down this year, almost half will make the entrepreneurs richer, through sale and succession. Another quarter of the entrepreneurs will have benefited from their businesses, and walk away ready to start their next firm. And start them they do. There is a special term for those owners who start multiple businesses in their careers—serial entrepreneurs.

CHAPTER SUMMARY 6-1 Describe the strategies for going into an entrepreneurial business on a full-time basis. People may set a goal for a business and then determine the resources that will be required to reach the goal. This is referred to as "causal or predictive reasoning." People may assess the assets available to them and the limits under which they must operate to establish the goal to be obtained and the methods of reaching the goal. This is referred to as "effectuation." 6-2 Describe five ways that people get into small business ownership. You may start a new business. You may franchise a business. You

may buy an existing business. You may inherit a business. You may be hired to be the professional manager of a small business. 6-3 Compare the rewards with the pitfalls of starting a new business. Advantages: A start-up begins with a clean slate and provides the owner with the opportunity to use the most up-to-date technologies and new unique products or services. It can be deliberately kept small to limit possible losses. Disadvantages: A start-up business has no initial name recognition and will require significant time to become established. It can be very difficult to finance. It cannot easily gain credit. It may not have experienced managers and workers. Page 189 Starting a new business from scratch can be made easier by using methods to reduce initial capital requirements and to gain access to business and industry experience, such as starting a business in your home to reduce start-up costs, having a partner to share capital, and making an alliance with your current employer to gain access to industry sources. 6-4 Compare the advantages and disadvantages of purchasing a business franchise. Franchising is a legal agreement that allows a business to be operated using the name and business procedures of another firm. There are four basic forms of franchising: Trade name Product distribution Conversion Business format Master franchises require opening multiple stores within a specified area. Advantages: A franchise has a proven successful business model. A franchise includes training and management support. You face less risk than in starting a new business or acquiring an operating business. Disadvantages: You have little control of business marketing and operations. Your success is determined to a large extent by the success of the franchisor. 6-5 Compare the advantages and disadvantages of purchasing an existing business. Advantages: Established customers provide immediate sales and cash inflows. Business processes are already in place in an existing business. Purchasing a business often requires less cash outlay than does creating a start-up. Disadvantages: It is very difficult to determine the value of a small business. Existing managers and employees may resist change. The reputation of the business may be a hindrance to future success. The business may be declining because of changes in technology. The facilities of the business may be obsolete or in need or major repair. There are multiple sources to help find businesses for sale, including: Business brokers Networking in the industry of interest Advertising of businesses for sale Your current employer's business You must do an exhaustive investigation to determine a business's suitability and value. 6-6 Explain four methods for purchasing an existing business. Buyouts are restricted to businesses that have a formal legal form of organization, including corporations, limited liability companies, and partnerships. A buy-in involves acquiring only part of the ownership of an existing business. Key resource acquisitions, also called bulk asset purchases, are the only manner in which a sole proprietorship may be purchased. A takeover involves purchasing enough of the target business's stock to gain control of the board of directors of the

business. 6-7 Explain the issues of inheriting a family-owned business. Family-owned businesses tend to fail after the death or retirement of the founder. Those family businesses that make the transition from the founder to the next generation take specific actions to organize the business. 6-8 Describe how hired managers become owners of small businesses. Entry into ownership by employee managers may be accomplished in three ways: leaving present employment to start up a new business, buying out or buying into a business, or contracting a franchise relationship. 6-9 Identify the choices for exiting the business. Exit strategies include terminations and transfers. Strategies like walkaways and pass offs don't produce financial outcomes for the original owners. Other types of business exit produce revenue for owners. Owners may work out outstanding debts or face bankruptcy. Smart owners plan ahead for their exit.

KEY TERMS causal (predictive) reasoning effectual reasoning affordable loss strategic partnerships leverage contingencies bootstrapping bricolage lean business practices minimum viable product start-up asset revolving credit founders accelerator synergy spin-off franchise trade name franchising product distribution franchising conversion franchising business format franchising due diligence caveat emptor intangibles discounted cash flows book value net realizable value replacement value earnings multiple heuristic point of indifference buy-in takeover buyout employee stock ownership plan (ESOP) transfer termination sell off pass off walkaway workout bankruptcy serial entrepreneur

DISCUSSION QUESTIONS What is the best way to get into business? Why do you think so? If you were able to enter into any small business that you desired, what things would you look for in the business? Suppose you had arranged enough capital so that you could either buy into an existing Outback Steak House or could start your own independent steak house restaurant. What are the advantages and disadvantages of each alternative? Which would you prefer and why? Suppose that you have developed an idea for a new business service. You have limited capital and you do not want to drop out of college. How might you successfully start up a new business using your idea? One evening when you went to pick up your child at the KinderKare, the owner mentioned to you that she would like to sell the business. You have always wanted to run a day-care facility and would like to try to buy her business. What facts should you consider in making this decision? After discussing the KinderKare purchase with your banker, you decide to make a determined effort to purchase

the business. To make a good decision, what information must you have, and how will you get it? Based on the information you developed, you have decided that the maximum value of the KinderKare including the building and lot is $350,000. You have $35,000 that you inherited from your favorite great aunt. Your parents have promised to invest $35,000. Based on the $70,000 that you have available, the bank has promised to make you an SBA guaranteed loan of $70,000. What are your options if you wish to pursue this opportunity? You took a job bagging coffee for a business that purchases directly from Guatemalan farmers, thereby getting the coffee at a bargain price, while still paying the farmers above market for the coffee. Working with all that caffeine has you charged up about going into business for yourself. The owner is only 60 years old, but he has told you that he'd like to slow down. He has offered to sell you all or part of the business. What things should you consider in making a decision about what to do?

EXPERIENTIAL EXERCISES Using the resources of your library, find the name and address of an active business broker in your area. Arrange an interview with the broker. Write a report detailing what methods the broker uses to place a value on a business for sale. Find out how the owner of the business where you are employed got into business. Visit the Small Business Administration website franchising page at www.sba.gov/starting-business/how-start-business/business-types/franchise-businesses. Using the links on that site, find a franchise business that you believe might be successful were you to buy it. Contact the franchisor, explain your interest, and find out the specifics of the franchise opportunity. Report your findings to your class.

MINI-CASE TOO HOT TO HOLD Gwendolyn Bonnefille, a single mother, is barely scraping by. Although she earns a fair salary working in the accounts receivable department of a local business, she has to pay for child care for her two children, Samantha who is five and Merlin who is three. While surfing the web, under a listing titled "businesses that can be moved," she found for sale a business that makes a great hot sauce called Caterwauling Coyote, with the slogan, "You'll howl at the moon!" The sauce is made in the owner's kitchen, bottled, labeled, and then delivered to gift and specialty shops in southern Texas. The equipment to make the sauce is commercial quality and appears to be in good condition. The business financial statements and the owner's 1040 Schedule C business tax returns do not agree. The financial statements show that in the most recent year the

business earned $60,000 on sales of $200,000. The 1040 Schedule C shows a profit of only $10,000, and a zero tax liability because of deducting losses suffered in prior years. The sellers are asking $240,000 for the business. They are willing to finance $190,000 at 10 percent for 15 years. When Gwendolyn sat down with the owner, Sylvester Gatos, he attempted to explain the discrepancy between the accounting and the tax returns. "You see," Sly said, "there are two things. First, some of the expenses on the schedule C aren't really business expenses, if you know what I mean. Second, when we did the income statement, we took out depreciation, interest, property tax, and the money that we used from the business because a buyer will not have those expenses." CASE DISCUSSION QUESTIONS What do you think about Sly's explanation of the differences between his income statement and his 1040 Schedule C? Suppose that the income statement is reasonably accurate. What do you think about the purchase price? What information should Gwendolyn obtain before making a decision to purchase the business?